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May 16, 2000

MAY 16 2000

VIA HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Case Control Unit
Attn.: STB Ex Parte 582 (Sub-No. 1)
1925 K Street, N.W.
Washington, DC 20423-0001

RE: STB Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*

Dear Secretary Williams:

Enclosed please find the original and 25 copies of the Comments of The Kansas City Southern Railway Company in the above-captioned proceeding. A copy of the Comments is also enclosed on a 3.5-inch disk in MicroSoft Word format.

Please acknowledge receipt of these Comments by file-stamping the extra copy and returning it to the person making the filing for return to me.

Sincerely,

William A. Mullins

cc: All known parties of record

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

ADVANCE NOTICE OF PROPOSED RULEMAKING

COMMENTS OF THE
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May 16, 2000

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TABLE OF ABBREVIATIONS AND ACRONYMS

AAR	Association of American Railroads
Amtrak	National Rail Passenger Corporation
ATSF	The Atchison, Topeka & Santa Fe Railway Company
BEA	Business Economic Area
BN	Burlington Northern Railroad
BNSF	The Burlington Northern and Santa Fe Railway Company
CMA	Chemical Manufacturers Association
CN	Canadian National Railway
CNW	Chicago & North Western Transportation Company
Conrail	Consolidated Railroad Corporation
Cotton Belt	St. Louis Southwestern Railway Company
CSX	CSX Transportation, Inc.
D&H	Delaware & Hudson Railway
DOJ	U.S. Department of Justice
DOT	U.S. Department of Transportation
FEC	Florida East Coast Railway Company
HBT	The Houston Belt & Terminal Railway Company
IC	Illinois Central Railroad
ICC or the Commission	Interstate Commerce Commission
KCS	The Kansas City Southern Railway Company
MKT	Missouri-Kansas-Texas Railroad
MP	Missouri Pacific Railroad Company
MRL	Montana Rail Link
NIT League	National Industrial Transportation League
NS	Norfolk Southern Corporation
PTRA	Port Terminal Railroad Association
RIA	Rail Industry Agreement
RBMN	Reading, Blue Mountain & Northern Railroad
SP	Southern Pacific Railroad
STB or the Board	Surface Transportation Board
Tex Mex	The Texas Mexican Railway Company
UP	Union Pacific Railroad
V.S. Grimm	Verified Statement of Dr. Curtis Grimm
WCL	Wisconsin Central Ltd
WP	Western Pacific Railroad

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

ADVANCE NOTICE OF PROPOSED RULEMAKING

By decision served March 31, 2000 in the above docketed proceeding,[1] the Surface Transportation Board ("STB" or "Board") solicited public comment on modifications to its regulations at 49 C.F.R. Part 1180, Subpart A (49 C.F.R. §§ 1180.0—1180.9), which govern proposals for rail consolidations. In its *ANPR*, the STB determined that, in light of significant changes in the scope and structure of the railroad industry since the last major overhaul of rail merger regulations[2] and the substantial questions surrounding whether recent mergers have produced the customer benefits promised by merger proponents, a reexamination of the Board's merger regulations was required. *ANPR* at 3. The Kansas City Southern Railway Company ("KCS") hereby provides the following comments and proposed modifications.[3]

The Board's decision to reexamine its regulations governing major rail mergers could not have come at a better time. For a number of years, KCS has publicly expressed its views that the

[1] *Major Rail Consolidation Procedures*, Ex Parte No. 582 (Sub-No. 1), Slip op. (STB served March 31, 2000) ("*ANPR*").

[2] *See Railroad Consolidation Procedures*, 363 I.C.C. 200 (1980).

[3] KCS is also a signatory to the Comments filed by the Association of American Railroads ("AAR") and generally supports the positions taken therein. KCS' individual comments contained herein are intended to supplement, and in some cases supplant, those provided by AAR.

regulations were outdated and inadequate to deal with the current market structure and framework of the railroad industry. Indeed, KCS' involvement in the merger of Burlington Northern Railroad ("BN") and The Atchison, Topeka and Santa Fe Railway C npany ("ATSF"),[4] and the merger of Union Pacific Railroad ("UP") and Southern Pacific Railroad ("SP")[5] was premised in large part upon urging the Board to focus on whether the potential anti-competitive elements of those mergers could be adequately identified and remedied through existing merger guidelines and policies.

KCS' views were verified during the Board's March 7-10 hearings when testifying witnesses, while disagreeing on other issues, were almost unanimous in their opinion that the Board's existing regulatory framework with respect to rail mergers was in need of revision.[6] These parties conclusively established that existing merger regulations do not comprehend the challenges facing the rail industry today, and therefore should be revised. The Board cannot ignore the fact that its merger regulations have not kept pace with the modern rail industry. Merger approval cannot occur in a vacuum, but rather must be responsive to the changing needs of a dynamic industry.

[4] *Burlington N. Inc. et al. -- Control and Merger – Santa Fe Pac. Corp. et al.*, F.D. 32549 ("*BN/SF Merger*").

[5] *Union Pac. Corp. et al. – Control and Merger – Southern Pac. Rail Corp. et al.*, F.D. 32760 ("*UP/SP Merger*").

[6] For example, Secretary of Transportation Rodney Slater called upon the Board to use the Ex Parte No. 582 proceeding to "refine your view of rail consolidations." *Statement of United States Secretary of Transportation Rodney Slater*, Ex Parte No. 582, dated March 7, 2000, p. 1; OG&E Electric argued that the Board was "well advised to review the policies applicable to the rail industry, and in particular to rail mergers, to determine if the policies applicable to past circumstances are appropriate for the challenges facing the customers and providers in the industry in the future." *Comments Submitted on Behalf Of OG&E Electric Services*, Ex Parte No. 582, dated February 29, 2000, p. 1; and the American Farm Bureau Federation agreed, commenting that existing merger policy "may not be sufficient to protect the interests of captive shippers." *Statement of the American Farm Bureau Federation*, Ex Parte No. 582, dated March 10, 2000, p. 4.

Given the sweeping changes which have occurred in the rail industry in recent decades, it is entirely appropriate to observe that many of the challenges facing the rail industry today were clearly not contemplated when the current regulations were fashioned in the early 1980's. At that time, the Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895 (1980) ("Staggers Act") had just recently been enacted, and the rail industry faced far different challenges. As the Board and many other parties have correctly observed, major concerns for the rail industry then focused on Class I bankruptcies, wholesale abandonments of main line track, and government ownership of failing rail franchises. To address these concerns, the Interstate Commerce Commission ("ICC" or "Commission") designed merger regulations to pare track of excess capacity and facilities, release rail carriers from outmoded pricing restrictions, and return railroads to economic vigor.

While those goals remain laudable where applicable, the existing merger regulations obviously do not adequately balance all of the concerns presented by a modern rail merger. The Board's recent findings in this docket confirm as much. *Public Views On Major Rail Consolidations*, Ex Parte No. 582, Slip op. at 6 (STB served March 17, 2000) ("*Public Views*") ("The goals of that merger policy have largely been achieved. It does not appear that there are significant public interest benefits to be realized from further downsizing or rationalizing of rail route systems."). To modernize the rail consolidation rules, prevent further service and competitive problems, and promote a balance between the needs of shippers and railroads, KCS strongly believes that the Board needs to require of all future merger applicants (a) the full disclosure and analysis of all potential merger impacts, and (b) compelling justification for any merger impacts that may hinder or otherwise limit competition and investment. Accordingly, KCS proposes seven changes to the existing rail consolidation procedures, all soundly grounded in economic and industrial theory, and all designed to improve the Board's ability to determine whether merger applications comport with the public interest.

1. **Rail Service Options Should Be Preserved In Merger Proceedings**

   It is in the public interest to preserve the rail service options available to shippers that existed prior to a merger, unless there is a substantial public interest justification for reducing the number of independent carriers.

2. **Service Restrictions Contained In Marketing, Haulage And Trackage Rights Agreements Imposed As Merger Conditions Should Be Disclosed And Justified**

   Service restrictions imposed on carriers offering competitive alternatives, contained in marketing, haulage and trackage rights agreements, may no longer be in the public interest and should be justified if retained.

3. **Benefits Claimed From Prior Mergers Should Be Preserved**

   If benefits are claimed in previous mergers, those benefits should not be abandoned in a subsequent merger without an offsetting condition.

4. **Applicants Should Be Required To Disclose And Discuss The Impact Of Related Negotiated Agreements In Merger Proceedings**

   It is in the public interest to provide an opportunity for the public to review and analyze the impact of agreements negotiated during the course of merger proceedings.

5. **Recent Cancellations Of Reciprocal Switching Access Should Be Disclosed And Discussed**

   It is in the public interest to require disclosure of instances where reciprocal switching access has been canceled within two years of the filing of a notice of intent to file a merger application.

6. **The Definition Of "Major" Merger Transactions Should Be Limited To Mergers Involving Only The Largest Railroads**

   It is in the public interest to streamline regulatory approval of control transactions involving all but the nation's largest railroads, except where such transactions are hostile

7. **Merger Applicants Should Be Required To Disclose And Discuss Paper And Steel Barriers Applicable To Their Shortline Interchange Connections**

In the course of ever-increasing rail concentration, it is in the public interest to provide shippers and receivers located on shortline railroads with viable, competitive access to multiple trunk line carriers.

None of the foregoing changes dictate any given result. They do not saddle future transactions with burdensome conditions undermining merger benefits. Nor do they limit the Board's ability to complete a timely, thorough review of all relevant issues on a case-by-case basis. Instead, they allow for the development of a full record and provide all parties an opportunity to comment, which should collectively minimize post-merger service disruptions, maintain competition, and best serve the public interest. In short, KCS' proposed changes will assist in restoring a harmonious balance to railroad regulation.

I. RAIL SERVICE OPTIONS SHOULD BE PRESERVED IN MERGER PROCEEDINGS

Introduction

In its *ANPR*, the Board indicated that it would consider whether it should alter its rail merger policy to place a greater emphasis on promoting and enhancing competition, rather than simply preserving competition. *ANPR at 7.* As part of its analysis, the Board sought comment on how its "assessment of 'three-to-two' effects should be reflected in our new merger rules, or whether this issue is best left to a case-by-case examination based on the individual circumstances of each case, as it has been in the past." *Id.* at 9. Implicit in this statement is the Board's belief that it is in the public interest to preserve competition. KCS agrees and believes that it is in the public interest to preserve the rail service options available to shippers and receivers that existed prior to a merger. Indeed, this fundamental premise should be the Board's chief guiding principle in any merger proceeding.

To this end, the Board's existing approach to analyzing the competitive impacts of major rail mergers needs to be modified, especially in situations where the competitive rail options in a given market or corridor will be reduced by the merger from three to two. While the Board professes to conduct its competitive analysis with respect to "three to two" issues on a case-by-case basis, and impose conditions when there is a diminution of competition, an analysis of the Board's recent merger decisions indicates that the Board has rarely imposed a condition to preserve competition at three to two locations or corridors. Indeed, in recent history, requests for conditions from shippers and receivers who clearly established that an impending merger reduced their competitive options from "five to four, four to three, or three to two" have been almost unanimously denied, usually based on an analysis that concluded that the proven reduction in competition was not of sufficient concern to merit relief.

Given the increased consolidation of the rail industry (and the manifest potential for future consolidation), KCS believes it is now more important than ever for the Board to adopt a clear policy that all competitive rail options in future merger proceedings will be preserved unless there is a substantial public interest justification for reducing those options. In this regard, it is especially important to give increased consideration to the harmful competitive effects of so-called three to two situations. This view is supported and endorsed by the attached verified statement of Dr. Curtis M. Grimm, Professor and Chair of Logistics, Business, and Public Policy, College of Business and Management, University of Maryland at College Park, attached hereto as Exhibit A ("V.S. Grimm"). Additional support for the proposition that the reduction of competitive options from three to two causes harm can be found in the written comments filed by Edison Mission Energy Company, Edison Electric Institute, and the Canadian Fertilizer Institute in *Public Views*.

Existing Policy

Historically, the Board has professed to using its merger authority not to improve or enhance competition, but only to maintain the level of competition that existed prior to a merger. *See, e.g., Union Pac. Corp. et al. - Control And Merger - Southern Pac. Rail Corp.*, F.D. 32760 (Sub-No. 26), Decision No. 10, Slip op. at 4 (STB served Dec. 21, 1998) (in *UP/SP Merger*, the Board "adopted several conditions to preserve competition"); *UP/SP Merger*, Decision No. 88, Slip op. at 7, n.17 (STB served March 21, 2000) ("The general build-out condition was imposed in order to preserve, not to improve, pre-merger build-out options."); *CSX Corp. and CSX Transp., Inc., Norfolk S. Corp. and Norfolk S. Rwy. Co. — Control and Operating Leases/Agreements — Conrail Inc. and Consolidated Rail Corp.*,[7] F.D. 33388 ("*Conrail Merger*"), Decision No. 89, Slip op. at 49 (STB served July 23, 1998)[8] ("*Conrail Merger Decision*") ("In assessing the probable impacts [of a rail consolidation] and determining whether to impose conditions, our concern is the preservation of competition and essential services, not the survival of particular carriers."). Indeed, the Board's merger regulations contain a policy statement regarding the harmful competitive effects of a reduction in competition and state that "[i]n some markets, the Board's focus will be on the preservation of effective intramodal competition." 49 C.F.R. § 1180.1(c)(2)(i).

The STB's *ANPR* characterizes its past approach to assessing potential reductions to competition as a "case-by-case examination based on the individual circumstances of each case." *ANPR* at 9. Yet, if this were true, and if the Board truly did take a case-by-case approach to imposing conditions in "some markets" to preserve competition, one would expect the case

[7] Consolidated Rail Corporation is referred to herein as "Conrail."

[8] *Appeal docketed sub nom. Erie-Niagara Rail Steering Committee v. STB*, No. 98-4286 (filed 2nd Cir. July 31, 1998).

record to reflect at least some instances of preserving competition in a three to two or "four to three" situation. Instead, the Board, in recent history, has rarely imposed a condition preventing the loss of rail alternatives unless the loss would have created a "two to one" situation. This strong presumption against imposing conditions to remedy the competitive effects of reductions in competition in three to two situations has been repeatedly confirmed. It appears that the Board has simply decided that the rail policy of the United States Government should be "two is enough."

This policy began to emerge in the BN-ATSF merger where the ICC suggested that two railroad competition was all that is needed:

> We would not necessarily be concerned if [the shipper] faced a reduction in competitive alternatives from three unrestricted alternatives (BN, Santa Fe, and UP) to two unrestricted alternatives (BN/Santa Fe and UP). Two independent railroads, we think, can provide strong, effective competition provided that, among other things, neither is subject to any artificial restrictions.

BN/SF Merger, 10 I.C.C.2d 661, 776 (1995) ("*BN/SF Merger Decision*"), *petition for review denied sub nom. Western Resources, Inc. v. STB et al.*, 109 F.3d 782 (D.C. Cir 1997). This view was later confirmed in the UP-SP merger when the Board no longer merely suggested, but made it clear, that "[w]e now believe that rail carriers can and do compete effectively with each other in two-carrier markets." *UP/SP Merger*, 1 S.T.B. 233, 385 (1996) ("*UP/SP Merger Decision*"), *petition for review denied sub nom. Western Coal Traffic League, et al. v. STB, et al.*, 169 F.3d 775 (D.C. Cir. 1999).

Perhaps the most striking example of the Board's reluctance to impose conditions to preserve the loss of competition in three to two situations was in *UP/SP Merger*. According to the U.S. Department of Justice ("DOJ") and others, the amount of total rail revenue in three to two markets was approximately $5 billion. Exhibit A, V.S. Grimm at 7. In many of these markets. UP and SP were the two dominant carriers before the merger. According to Dr. Curtis Grimm, UP and SP had a combined market share of 70% or greater in the three to two markets worth $2 billion in rail revenue. In other words, in *UP/SP Merger*, the two dominant carriers were being combined in many markets. Nonetheless, the Board concluded that three to two effects would not be a problem. The Board based this conclusion on two findings:

First, it stated:

> We have examined in detail the nature of the 3-to-2 traffic at issue, and have determined that it presents little potential for significant, merger-related competitive harm. Most of this traffic is either intermodal or automotive traffic that enjoys vigorous motor carrier competition.

UP/SP Merger Decision at 387. Second, it stated:

> Another key factor in our analysis is the limited role now played by SP as the third carrier in these markets. . . . As a result, SP's role, particularly with regard to the very service-sensitive automotive and intermodal traffic that makes up a large part of the 3-to-2 traffic, has diminished. (According to applicants, SP now handles only 20% of 3-to-2 traffic.)

Id. at 390.

However, even accepting the Board's general findings with respect to three to two traffic as fact, neither of these findings applied to the Houston, Texas market.[9] In terms of three to two effects, that market experienced competitive harms resulting from the loss of a third major carrier far more severe than in other markets. First, unlike many other three to two markets discussed in the Board's decision, very little of the Houston three to two traffic was intermodal, automotive or

[9] In the Houston area, just prior to *UP/SP Merger*, a significant number of Houston chemical shippers were served, either directly or via reciprocal switch, by the Port Terminal Railroad Association ("PTRA") and The Houston Belt & Terminal Railway Company ("HBT"). The PTRA and HBT provided these shippers with neutral switching and dispatching and gave them the opportunity to use either of the three carriers serving Houston--the BNSF, SP, or UP--for the linehaul move to all gateways, including Mexico. As a result of the UP-SP consolidation, these HBT and PTRA shippers saw their competitive options reduced to two — UP and BNSF — for all movements to all gateways, except Mexico.

otherwise subject to truck competition. Exhibit A, V.S. Grimm at 7-8. Second, unlike many other three to two markets, SP's role was not "diminished" in Houston. Indeed, it had been a major competitor in Houston, and was in fact far more significant than The Burlington Northern and Santa Fe Railway Company ("BNSF"). For example, UP and SP controlled 85-100% of the markets for $504 million of the total three to two Houston traffic. Approximately $307 million of this traffic was chemicals. *Id.* at 8. Therefore, the loss of SP as a third competitor was much more harmful to shippers in the Houston market than elsewhere.

One would think that in a market in which the two dominant rail carriers planned to merge, the Board would have protected the shippers by imposing at least one condition to preserve three competitive rail options. Nonetheless, the Board concluded that the mere presence of BNSF in these markets would be enough, in a post merger environment, to provide an effective competitive alternative, despite the very marginal role played by BNSF in many Houston markets. In other words, two carriers was enough, regardless of the ability and desire of those two carriers to compete for traffic in that market.

In defending its intended reduction of competition at Houston, UP took issue with the use of a "Business Economic Area" ("BEA") for determining the total three to two or two to one traffic at risk in Houston and elsewhere, preferring to use specific points instead of BEA's. Assuming that a specific point should be the relevant market definition, there were many stations, shippers, and receivers who were at three to two points, yet the Board still did not impose even one condition to preserve competition for three to two shippers located at specific points (or stations) within the Houston market.

UP and the Board also took issue with the characterization of this three to two traffic as rail dependent traffic. The Board said "[a] significant amount of the traffic at Houston points served directly or by reciprocal switching by three rail carriers before the merger, but by only two carriers after, is truck-competitive intermodal traffic." *UP SP Merger*, Decision No. 62, Slip op. at 7 (STB served Nov. 27, 1996). Even assuming the STB was correct, this statement still implicitly acknowledges that there was at least some traffic at Houston three to two points that was not truck competitive and for which the merger would cause a reduction in competition from three to two. Moreover, the Board's analysis ignores the relative strength of the carrier to be eliminated, SP. If the STB truly intended to preserve competition in some (indeed, any) three to two markets, one would have thought these non-truck competitive Houston points would have received some form of competitive relief. They did not.

Thus, regardless of how one viewed the Houston market (points *vs.* BEA's, truck competitive traffic *vs.* rail dependent traffic, market shares *vs.* counting the number of railroads), undeniably some shippers in Houston, who were unable to use trucks, had their rail options reduced from three to two, and one of two dominant carriers was eliminated for hundreds of millions of dollars of traffic. The Board simply rejected claims of competitive harm in this market. Yet, it would have been relatively easy to "preserve competition" for many such shippers by not imposing the northbound "paper barrier restriction" placed on the trackage rights through the Houston market granted to The Texas Mexican Railway Company ("Tex Mex"). Based on the fact that the STB rejected the views of DOJ, Dr. Lawrence J. White, Dr. William G. Shepherd, Dr. Richard L. Schmalense, Dr. Curtis Grimm, Dr. William B. Tye, Dr. Henry B. McFarland, Dr. James M. McDonald, and Dr. George H. Borts, all of whom expressed concerns over the merger and its competitive effects, especially in three to two markets, one can only conclude that the STB believes "two is enough."[10]

[10] This "two is enough" policy continued in the *Conrail Merger* (where in a significant number of markets Conrail, Norfolk Southern Corporation ("NS"), and CSX Transportation, Inc.

Given this record and the current state of the rail industry, KCS believes that rather than focusing on bottlenecks, one-lump theories, mandatory reciprocal switching and other such radical competitive access ideas, the Board could go a long way toward elevating the role of competition by simply doing what it is supposed to do--preserve competition. One way to accomplish this is to make a clear policy statement in the Board's merger regulations that it will preserve the number of independent carriers serving any shipper, terminal, or corridor in all future merger proceedings unless there are substantial public interest justifications not to do so.

Proposed Modification To Existing Regulation

KCS believes that the Board should delete, in its entirety, current 49 C.F.R. 1180.1(c)(2)(i), and insert in its place, the following policy statement:

> *Reduction of Competition.* It is in the public interest to preserve the number of independent rail carriers serving any terminal facility, station, or origin/destination corridor. Accordingly, any major rail merger application shall include a detailed plan to ensure that there is no reduction in the number of independent carriers serving any terminal facility, station, or origin/destination corridor or set forth facts showing that there is a substantial public interest justification for reducing the number of independent carriers. To the extent the application does not include such a detailed plan and unless there are substantial public interest justifications for not doing so, the Board will, upon request, impose conditions to preserve the number of independent carriers serving such a terminal, facility, station, or origin/destination corridor.

Impact Of The Proposed Modification

The substantive effect of KCS' proposed policy statement would be twofold: (1) place a greater emphasis on competitive effects by focusing the Board's analysis of anticompetitive effects in major transactions on preserving the number of independent rail carriers currently serving a given market or corridor; and (2) impose a requirement that conditions will be imposed

("CSX") competed), but no condition was imposed to alleviate a three to two effect. The conclusion is inescapable -- the Board must believe two railroads are enough competition in any given market.

to preserve the number of independent rail carriers serving a given market or corridor unless the merger applicants can establish substantial public interest justifications for not imposing such a condition. This, in effect, shifts the burden of proof with respect to the imposition of conditions that are designed to remedy the loss of competition.

Under current policy, the proponent of a condition designed to preserve competition must meet a very difficult test for justifying its request. As noted above, the Board has consistently ruled that proponents of conditions intended to preserve the number of rail service options at five to four, four to three, or three to two locations have, in the Board's view, almost invariably failed to meet their burden. The proposed new policy will establish a presumption that conditions intended to preserve the number of independent rail carriers serving a given market are in the public interest and will be imposed.

While the proposed new policy will establish a presumption in favor of preserving competition, the policy will not necessarily guarantee that there will be no reduction in intramodal competition in future mergers. Instead, the policy establishes a rebuttable presumption. Merger applicants will be able to argue that a requested condition should not be imposed if they present evidence of substantial public interest reasons for not imposing the condition.

<u>Justification For The Proposed Modification</u>

Recent merger decisions clearly show that the Board maintains a strong presumption against imposing conditions to preserve competition at three to two points or corridors. In the absence of a clear overall policy regarding three to two competitive effects and without a change in the Board's current approach to three to two issues, the rail industry will inevitably merge itself down to two railroads. KCS, supported by Dr. Grimm and numerous other economists, believes it would not be in the public interest to have only two large railroads serving the entire United States. Rather, it should be the policy of this Board to preserve the few remaining competitive rail options. KCS' proposed policy will not stifle the development of further rail efficiencies, because such efficiencies can be achieved short of merger through alliances, marketing agreements, joint dispatching arrangements, and other forms of voluntary coordination.

A. Public Policy Should Discourage The Creation Of Two Mega-Railroads

If the Board's "two is enough" policy does not change, the rail market will inevitably merge into two railroads in North America. History tells us that growth through mergers has been matched with corresponding growth through more mergers. Witness the Eastern railroad mad scramble for merger partners in the 1960's. In the West, BN's acquisition of the St. Louis-San Francisco Railway Company was quickly countered by the UP merger with Missouri Pacific Railroad Company ("MP") and Western Pacific Railroad ("WP").[11] Shortly thereafter, the East saw the creation of the new CSX mega-system countered by the creation of the NS system. Back in the West, UP justified its control of Chicago & North Western Transportation Company ("CNW") as a counter to the purchase of SP by The Denver and Rio Grande Western Railway Company. UP has publicly stated that its merger with SP was a direct response to the BN-ATSF merger. Finally, we must not forget that the split-up of Conrail between NS and CSX was, in essence, a compromise reached because neither one wanted the other to acquire the whole of Conrail, and thereby be facing a much larger competitor. We now have BNSF and Canadian National Railway ("CN") proposing a merger, with corresponding threats by the other mega-Class I carriers that they will also merge if BNSF and CN are allowed to merge. *See Public*

[11] *Union Pac. Corp. et al. -- Control -- Missouri Pac. Corp. et al.*, 366 I.C.C. 462 (1982) ("*UP/MP/WP Merger*").

Views at 3, wherein the Board found that "the Class I railroads have clearly stated that they would find it necessary to respond [to a BNSF-CN combination] in kind, and there is a substantial possibility that, absent decisive action on our part, in the very near future, we will likely be left with the prospect of only two large railroads serving North America."

Railroads will not let their competitors become measurably larger than themselves without obtaining equalization through their own responsive combinations. Such reactive behavior is seen as logically consistent with the natural inclination of a competitor to maintain competitive parity, while striving for a competitive edge. Maintenance of comparable size is thought to be required to maintain leverage on issues such as rate divisions, and to replace gateways when friendly connections are swallowed up by one's competitors. As long as the Board's merger policy continues to stress that "two is enough," the logical end point of that policy will be two major rail systems in North America.

The creation of two transcontinental rail carriers would raise a host of concerns. These two major rail systems would dominate shortline and regional railroads and thwart the influence those smaller carriers currently have on rail prices and services. Large mega-systems can become just too big, where they suffer diseconomies of scale because the "machine" is beyond the capabilities of its operators, as shown by UP's decentralization of operational control following its 1997-98 service crisis. The bargaining leverage of individual shippers would be significantly reduced. Exhibit A, V.S. Grimm at 13 n.23.

Even if there was some form of government-imposed competitive access so that shippers would have bottleneck relief or mandatory switching, and thus some form of access to the two mega-carriers, the end result would not be natural competition, but contrived competition. Two mega-carriers, even with shippers granted some form of competitive access, would, in the end, stifle competition and investment and lead to reregulation.

1. Duopoly Reduces The Intensity Of Competition

Economic theory provides no basis for a policy disregarding three to two competitive reductions in rail mergers. As discussed by Dr. Grimm in his attached verified statement, most economists support the notion that moving from three competitors to two in a market leads to an inexorable diminution of competition and to higher rates for shippers.

In general, with additional competitors, or firms, coordination or tacit collusion becomes more difficult. A greater number of firms increases the probabilities that the firms will have different notions about what price levels will maximize profits. Therefore, as the number of competitors in an industry increases, the intensity of rivalry also will tend to increase. While two firms in any industry will in most instances compete to some degree with each other, rivalry will generally be more vigorous when a third firm is present--with customers receiving more options, better service and lower prices. Accordingly, when a third rival is eliminated from a market, prices increase and service quality is diminished. *Id.* at 10.

The existing academic research confirms that rail rates are significantly related to the degree of railroad competition. This research indicates a significant relationship between rates and rail competition, establishing that added competition causes lower rates. *Id.* at 11. Much of this research was discussed in recent merger cases, particularly *UP/SP Merger*. For various reasons, the Board has found this research not to be relevant to competitive issues in specific cases. Nonetheless, these studies strongly suggest that a presumption of no competitive harm from three to two's, which seems to be the Board's current policy, is not warranted. Clearly, these studies show that rail competition is critically hampered when only two carriers serve certain shippers or markets.

The KCS proposal restores the importance of competition in merger analysis. Importantly, the proposed policy statement does not eliminate the need for a continued case-by-case analysis of the competitive effects of a given transaction. Such an analysis must still occur. Instead, KCS' proposal simply requires the preservation, in future merger proceedings, of the limited rail service options that currently exist for shippers. Even under the proposal, reductions from four to three or three to two can occur if such reductions are proven to be substantially in the public interest.

2. Duopoly Would Result In Reregulation

In the end, two major railroads would be perceived as so destructive to competition and the needs of rail customers that the railroad industry would likely be re-regulated. *Id.* at 10 n.15. Reregulation would be disastrous for the rail shippers of North America and the North American economy, as well as the railroads themselves. Those large systems will have no incentive to partner with KCS in routes and service because they will have their own routes.

Additionally, KCS' role as an effective competitor would be undermined by reregulation as much or more than it would by further mergers of its Class I competitors. Such practices as open reciprocal switching or reversal of the "bottleneck" decision would leave regional railroads at the mercy of the large Class I railroads. Those larger Class I's will reach into the regional railroads' markets and, by means of their much broader market coverage, take traffic from the regional railroads to such an extent as to drive smaller carriers out of existence. Shortlines might survive in areas which the Class I's do not consider worth serving, but a national rail system consisting of but two Class I railroads would spell the demise of the regionals, leaving KCS no choice but to become a part of one of those two remaining Class I systems.

The loss of independent carriers, such as KCS and others, would be not be in the public interest. Through the Alliance Agreement with CN and Illinois Central Railroad ("IC"), KCS provides an essential independent competitive counterweight to the two dominant carriers in the East and West for service between the Midwest and Mexico. KCS' East-West routes, Meridian to Dallas and Kansas City to East St. Louis, respectively, function as strategic rail arteries, facilitating the movement of overhead traffic between eastern and western railroads by avoiding congestion at the major metropolitan cities of New Orleans and St. Louis. If additional mergers or reregulation eliminated this independent alternative, there would be a serious diminution of competition.

B. Mergers Are Not Necessary To Achieve Efficiencies

Some may argue that KCS' proposed policy statement would discourage mergers and prevent much needed efficiencies from being achieved in the rail industry. Yet, the proposal does not prohibit mergers nor does it eliminate the need to conduct a case-by-case analysis of any future merger. The proposal merely requires that competitive options be preserved if a merger is approved. Furthermore, the proposal provides for a rebuttable presumption. As such, to the extent merger applicants do not believe conditions preserving competition should be imposed--because, for example, such conditions would substantially reduce the benefits and efficiencies of the proposed transaction--merger applicants can prevent the imposition of the condition by presenting substantial public interest justifications for not imposing the condition.

To the extent carriers believe further efficiencies in the rail industry are needed, indeed necessary, alternative methods exist for obtaining these efficiencies. For example, competing railroads may integrate their dispatching systems (as has been done by UP and BNSF at Spring, Texas and by certain Chicago terminal switching carriers), thereby achieving a greater coordination of train movement through congested terminals. Similarly, voluntary coordination agreements and marketing alliances (such as the KCS/CN/IC Alliance Agreement) allow railroads to extend their market reach and utilize the resources of other railroads to improve customer service and provide stronger competitive options.

The partnership KCS entered into through its Alliance Agreement with CN and IC in 1998 provides an excellent example of such coordination and cooperation. Through the new Alliance routes, KCS has effectively produced a competitive interline route against the single line routings of BNSF and UP. The Alliance Agreement clearly established a major third option for rail shippers moving traffic between Canada and Mexico, and between the Midwest and Southwest and to points in between. Through these private agreements, the benefits of improved coordination and "single-line-like" service can be realized far short of merger.

The Board, the ICC, and DOJ have encouraged railroads to strike cooperative arrangements as an alternative to mergers. In *CSX Corp. – Control – Chessie Sys., Inc. et al.*, 363 I.C.C. 521, 555 (1980) ("*CSX/Chessie Merger*"), *aff'd* 698 F.2d 315 (7th Cir. 1983), the ICC stated that:

> Many of the service benefits that can be obtained through consolidation can also be obtained by working agreements between the parties. Run-through trains, trackage rights, joint use of facilities, equipment sharing, preblocking of trains, and renegotiated revenue divisions could provide some measure of benefits to the respective systems. We strongly encourage the rail industry to utilize the many alternatives available to it.

DOJ has also taken the view that any operating efficiencies that could be obtained by the merger of two rail carriers could be obtained by cooperative steps short of merger. For example, in *UP/SP Merger*, DOJ's witness, Dr. Laurits Christensen, testified that with proper coordination, "interline hauls can be competitive with single-line hauls." (*UP SP Merger*. Verified Statement of Dr. Laurits R. Christenser Comments of DOJ (DOJ-8), at 15), and that operating agreements "could provide some of the same benefits that are claimed by the Applicants to be available through the [UP/SP] merger." *Id.* Dr. Christensen concluded that the vast majority of alleged "public benefits" claimed through the UP-SP merger could in fact have been achieved through coordinations short of merger. *Id.* at 34-35.

Additional support for the competitive benefits provided by private agreement can also be found in the comments of rail industry leaders. For example, Gerald Grinstein, former Chief Executive Officer of BNSF, stated at the beginning of the most recent merger cycle that "the future of railroading lies in more coordination between railroads and not merger." Forbes, Dec. 18, 1995 at 64. When deposed in *UP/SP Merger*, he reiterated this point, agreeing with Dr. Christensen that interline service can be competitive with single-line service between the same points. *UP/SP Merger*, Deposition of Gerald Grinstein, February 16, 1996, at 51.

In summary, while the proposed policy statement does not prohibit mergers, to the extent carriers would be "chilled" from merging because of the competition-preserving nature of the proposed policy, these carriers can achieve many of the "merger type" public benefits without merging. As the Alliance proves, and as was testified to in prior ICC/STB cases, single-line efficiencies can be achieved without mergers and without reducing competition.

Conclusion

By adopting the KCS-proposed change in the Board's merger regulation policies, the Board would not be prohibiting mergers, nor would it be subjecting past merger decisions to a general reopening. The policy statement does not overhaul the statutory standards governing merger applications and it does not eliminate the need for a case-by-case approach to competitive issues. Instead, the policy statement simply elevates the notion of preserving competition as one of the primary goals to consider in any merger proceeding. Furthermore, the elevated role of competition could be rebutted. In the end, in light of the newly restructured and highly concentrated market, it is now more important than ever for this Board to make a clear statement that it views the preservation of competition as an important policy goal of the United States Government.

II. SERVICE RESTRICTIONS CONTAINED IN MARKETING, HAULAGE, AND TRACKAGE RIGHTS AGREEMENTS IMPOSED AS MERGER CONDITIONS SHOULD BE DISCLOSED AND JUSTIFIED

Introduction

In its *ANPR*, the Board indicated that it would consider altering its rail merger policy to place a greater emphasis on promoting and enhancing competition rather than on simply preserving competition. *ANPR* at 4. The *ANPR* then listed various suggestions that parties have put forth as the means to accomplish those goals. The proposals listed in the *ANPR* deserve consideration, but the worthy goals of promoting and enhancing competition could be furthered in an even more fundamental way. As the Board is aware, many of the conditions imposed by the Board in past rail merger cases have contained restrictions which limit the full commercial utility of the condition. In the context of a now heavily consolidated rail industry (which has the potential for even further consolidation), many of the restricted conditions imposed in prior mergers, which were crafted under a very narrow and restrictive public interest standard, may no longer make economic sense, and indeed may actually be impeding effective competition rather than promoting it. KCS therefore believes that the Board's review of future merger applications should include a reassessment of the continued validity of, and justifications for, any restrictions placed on conditions imposed in past merger proceedings involving the applicants or their predecessors.

In order to promote and enhance competition, the Board should require merger applicants to include in their control application (1) a full disclosure of all conditions granted to third parties in prior mergers in which they or their predecessors were involved, (2) an analysis of the continued validity of, or necessity for, any restrictions (operating, access, traffic, etc.) contained in prior conditions, and (3) an assessment of whether or not those conditions could be modified in such a way as to actually promote and enhance competition, and whether the restrictions remain consistent with evolving notions of the public interest.

Existing Policy

The power to grant conditions, including the power specifically granted the Board to authorize trackage rights, is contained in the same section of the statute that requires the Board to grant an application only if it serves the public interest. That section provides in part that in approving a transaction:

> [t]he Board may impose conditions governing the transaction, including the divestiture of parallel tracks or requiring the granting of trackage rights and access to other facilities. Any trackage rights and related conditions imposed to alleviate anticompetitive effects of the transaction shall provide for operating terms and compensation levels to ensure that such effects are alleviated.

49 U.S.C. § 11324(c).

The Board's conditioning powers are thus intended to allow the Board to relieve public harm resulting from the control transaction as proposed. Yet, despite the fact that the statute does not place any restrictions upon the Board's ability to impose conditions, and despite the fact that the Board has repeatedly referred to its conditioning power as "broad" (*Conrail Merger Decision* at 78; *UP/SP Merger Decision* at 367), in practice the Board takes a very narrow view of when it can impose a condition, and the scope of the conditions that it can impose. Under current merger policy, conditions will not be imposed unless they satisfy a multi-part test:

> A condition must be operationally feasible, and produce net public benefits. We are disinclined to impose conditions that would broadly restructure the competitive balance among railroads with unpredictable effects. A condition must address an effect of the transaction, and will generally not be imposed "to ameliorate longstanding problems which were not created by the merger." Finally, a condition should also be tailored to remedy adverse effects of a transaction, and should not be designed simply to put its proponent in a better position than it occupied before the consolidation.

Canadian National Rwy. Co. et al. – Control -- Illinois Central Corp. et al., F.D. 33556 ("*CN/IC Merger*"), Decision No. 37, Slip op. at 21-22 (STB served May 25, 1999) ("*CN/IC Merger Decision*").

Historically, the Board has not used its merger authority to improve or enhance competition, but only to maintain the level of competition that existed prior to a merger. On occasion, however, the Board has used its conditioning authority to improve, not just preserve competition. For example, in the recent *Conrail Merger*, the Board granted trackage rights to Canadian Pacific Railway to serve shippers located east of the Hudson River, who prior to the Conrail split-up were served only by Conrail. This and other conditions were granted under the Board's:

> broad conditioning authority to preserve or enhance service and competitive opportunities for areas in the Northeast that lost significant competitive alternatives in the railroad bankruptcies that led to the formation of Conrail in the 1970s. We have either preserved competition or provided for new competition to and from New York City, Buffalo, and Rochester, NY.

Conrail Merger Decision at 53.

The Board's willingness to consider expanding, not just preserving, competition for certain shippers in *Conrail Merger* is indicative of the evolving nature of the Board's interpretation of the public interest. Indeed, much of the precedent of [the STB] and its predecessor reflects the policies of a different era. As the Board recognized in its *ANPR*, the current policy reflected in the Board's merger regulations is of an overbuilt, balkanized rail industry needing protectionist governmental policies to maintain a minimal level of customer service. *ANPR* at 3. Whatever the accuracy of that picture twenty years ago, it clearly is not true today. Currently, the rail industry is marked by the dominance of a handful of behemoth Class I carriers that serve dozens of states and exert significant power over shipper transportation decisions. No longer chained to the stringent interpretations of a "common carrier" that existed decades ago, today's mega-carriers are free to focus their resources on only the most profitable traffic, occasionally ignoring the needs of smaller carriers, shippers, and cities. In light of this ever-consolidating environment and the mega-carriers' movement toward investment only in certain major routes (and corresponding disinvestment in branch lines and feeder routes), shippers have clamored for more choice in their rail routing options. This Board has properly begun to reconsider whether it should exercise its "broad" merger authority to condition merger transactions to enhance, not just preserve, rail competition, all in furtherance of the public interest.

<u>Proposed Modification To Existing Regulation</u>

To ensure that merger conditions imposed in prior merger proceedings continue to serve in the public interest as currently interpreted, KCS proposes that the Board amend § 1180.6 of the current merger regulations by adding the following provision as subsection (c) and recodifying current subsection (c) as (d):

> (c) In a major transaction, applicants shall be required to identify all conditions imposed in any previously approved major transaction in which (1) any of the applicants have been previously involved; (2) the previously imposed condition was imposed in a major transaction approved after January 1, 1995; (3) the previously imposed condition was imposed to benefit a third party, such as a shipper, receiver, or a non-applicant carrier; and (4) the previously imposed

condition contains a commodity, geographical, or operational restriction that limits, in any way, the ability of a shipper, receiver, or carrier to use that condition to provide alternative competitive or service routings. For each such disclosed condition, applicants shall discuss the underlying rationale for such a condition and whether the original rationale remains valid under current merger policy. Applicants shall further assess whether the commodity, geographic, or operational limitation contained within that condition could be modified or removed to promote competition or provide alternative service routings. Upon request of any party, the Board will review such a disclosed condition and if the modification or removal of any such restriction contained within that condition would enhance competition or improve service to shippers, the Board will require modification or elimination of any such restriction unless there are substantial public interest reasons to prevent the removal of such a restriction.

Impact Of The Proposed Modification

KCS' proposed modification would allow the Board to use its conditioning authority to promote, rather than to merely preserve, competition. Importantly, the proposed rule does not dictate a given result, but simply imposes a disclosure and analysis burden upon applicants. The burden of providing information should be minimal. In addition to all of the information currently contained in merger applications, applicants would be required to add a new section listing all conditions imposed in prior mergers involving any of the merging carriers. The applicants would also be required to assess whether any restrictions contained in those conditions (such as limitations or exclusions on certain types of traffic, or limitations regarding origins, destinations, or origin/destination pairs, or restrictions on serving certain shippers) remain consistent with the Board's interpretation of the public interest. Finally, the applicants would be required to opine as to whether any such limitations on the rights granted by the conditions could be modified or removed in order to enhance competition or improve service.

It is important to note two limitations contained on KCS' proposed modification. First, although the Board would be reviewing the continued validity of conditions imposed in prior mergers, it would not be required to reopen any prior merger outside the context of one of the involved parties coming forward to seek future merger authority. Thus, third parties will not be given any more rights than they currently have to seek the reopening of old cases. The power over whether the Board would reassess old conditions would rest entirely with merging parties and would simply be a factor to be considered in contemplation of a merger. Second, and perhaps more fundamentally, the KCS proposal does not require the Board to make any changes to its views on what constitutes an appropriate level of competition, acceptable service, safety, or pricing. Instead, it merely asks the Board to take its existing notions of what constitutes the public interest and apply those notions to previous, and possibly outdated, conditions. To the extent that the conditions remain justified as being in the public interest, they would not be modified. However, to the extent those conditions contain restrictions which are no longer deemed appropriate, the restrictions would be lifted. In essence, this condition merely asks the Board to continue to apply its evolving notion of the public interest to past merger decisions.

Some parties might argue that KCS' proposed change to the Board's merger regulations really represents no change at all, as parties have traditionally been free to ask the Board to adjust the terms of merger conditions. While this may be true in some instances, KCS' proposal would formalize the process, requiring a review of the terms of old conditions as an element of approving any further mergers. KCS' proposal would also shift both the burden of coming forward, and the burden of proof, onto the parties seeking to merge. KCS believes that the best place to put the description and impact of these previously imposed conditions is in the body of the merger application, where they can be viewed within the context of the overall effects of the proposed merger transaction and its related public interest aspects. If restrictions to competition burdening these earlier-imposed conditions ostensibly remain in the public interest, it should be the burden of those favoring the continuation of those restrictions to demonstrate their worth.

Finally, KCS does not believe that the modification it has proposed will lengthen the merger review process. KCS is aware that the Board functions under deadlines for the completion of each merger proceeding, and KCS has no desire to compromise any portion of the Board's review because of those limits. Because the burden of identifying all prior restrictions on conditions, and of justifying those restrictions in light of current merger policy, would rest with the merger applicants, a presentation on these issues would be an element of the merger application. Thus, the core of the issue would be addressed at the beginning of the proceeding, allowing all parties more time to consider and comment on the relevant issues. Thus, the proposal will actually expand the amount of time dedicated to determining whether competition is being artificially constricted by outmoded restrictions, without extending the Board's schedule for reaching conclusions on the merits of the proposed transaction.

Justification For The Proposed Modification

Ample justification for KCS' proposed modification to the Board's merger regulations can be found in the words of the ICC, written twenty years ago:

> We have broad authority to impose conditions on railroad unifications. In the past we have imposed conditions to promote interstate transportation in the interest of the public and commerce of the people, to enhance competition, to improve the position of a carrier, to open new gateways, to establish new single-line service, to preserve the integrity of an important switching carrier, to preclude diversion of traffic, to compensate partially a railroad for its anticipated traffic losses, to protect railroads even though they will not suffer serious anticompetitive harm, and to aid railroads not likely to be harmed by the transaction.
>
> This has been our policy in the past. However, the overriding factor governing the imposition of all conditions in the past has been the public interest. <u>We would be remiss if we did not consider today's limits when imposing conditions on a railroad merger instead of viewing the industry as static</u>.

Burlington N. Inc. -- Control and Merger -- St. Louis-San Francisco Rwy. Co., 360 I.C.C. 788, 950 (1980) (emphasis added) (footnotes omitted). *See also Makita U.S.A., Inc. -- Petition For*

Declaratory Order – Certain Rates And Practices Of Milne Truck Lines, Inc., Docket No. MC-C-30164, 1992 WL 70300 (I.C.C. decided April 8, 1992). ("The volume and complexity of the Interstate Commerce Act combined with the changing nature of the transportation industry render ineffective any static policy.").

Unfortunately, absent a specific complaint by an allegedly aggrieved party, there currently is no formal method for reviewing the restrictions often placed on merger conditions and adjusting them to reflect current competitive theory and conditions. Unless a party files an *ad hoc* request for reconsideration or reopening, a process that has rarely, if ever, been successful in the past, old restrictions continue to restrain the competitive energies unleashed in the Staggers Act. Examples of these restrictions include limiting trackage rights to "overhead rights" (thereby prohibiting service to shippers located on adjacent property), traffic restrictions (which prohibit the movement of certain types of commodities or prevent the movement of traffic between certain origins or destinations), and excessive trackage rights fees (rendering the grant of rights useless). It is clear that none of these restrictions "promote and enhance" competition, and, depending upon the particular circumstance, they may no longer be in the public interest. Nevertheless, these restrictions remain in place without consideration of their continued utility.

Therefore, old conditions and restrictions should be disclosed and discussed in the context of new public interest policy whenever a merger application is filed. The initiation of a merger proceeding might provide the appropriate impetus for a third party (either a shipper or another railroad) to challenge the continued necessity of limitations preventing the full exercise of competition. Further, merging parties might be more willing to propose pro-competitive alternatives to existing restrictions if they knew that restrictions could be eliminated. Finally, by adopting the change proposed by KCS, the Board would not be subjecting all past merger decisions to a general reopening, nor would it be overhauling the standards under which it imposed conditions in the past. Rather, it would simply be reviewing the imposition of old conditions in light of the newly restructured and highly concentrated rail industry.

Reviewing the limitations and continued viability of provisions contained in conditions imposed in prior mergers is nothing new; what is new is the requirement imposed upon applicants to a merger proceeding to disclose, analyze, and justify the continued application of those conditions in light of the changed regulatory environment, rather than relying upon individual complaints. While KCS' proposal shifts the burden of proof applicable to such review, in all other respects the proposal merely continues the agency's policy of reviewing (and, where appropriate) removing restrictions imposed in prior mergers that are no longer deemed appropriate. As an example of this review, beginning in the 1920's, the ICC routinely imposed a standard set of traffic protection conditions on rail mergers. These conditions, known as "DT&I Conditions" because of their use in *Detroit, Toledo & Ironton R.R. et al. Control*, 275 I.C.C. 455 (1950) ("*DT&I*"), generally required that consolidated rail carriers maintain and keep open all routes via gateways existing at the time of combination. DT&I Conditions were also interpreted to require consolidated carriers to maintain single-line rates on a par with the joint-line rates existing at the time of combination. This was designed to prevent the consolidated rail carrier from using rate reductions over the newly created single-line route to attract traffic away from the existing joint line route, all of which was deemed to be in the public interest. *DT&I* at 492-93.

After the imposition of several decades of DT&I Conditions, as the railroad industry continued to change, the ICC became concerned that DT&I conditions actually impeded competition by inhibiting rate reductions, and harmed the public interest by depriving consolidated rail carriers and their shippers of the very efficiencies their combinations were intended to confer. In commenting on the use of DT&I Conditions, the ICC stated: "We take this opportunity to clarify that changed conditions require that we reassess our view of the DT&I conditions. We must adapt our regulation to this era of inflation and declining rail traffic and revenues." *Seaboard Coast Line R.R. et al. – Investigation of Control and Modification of Traffic Conditions*, 360 I.C.C. 582, 603 (1979). Finally, in *Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings*, 366 I.C.C. 112 (1982) ("*Traffic Protective Conditions*"), the ICC adopted a rule against imposing traffic protective conditions in future merger proceedings and revoked them in the consolidations that were previously approved.[12]

The lesson to be learned from the ICC's treatment of DT&I Conditions is that the concept of the "public interest" changes over time, and that it is inappropriate to continue to shackle railroads with outmoded and obsolete restrictive merger conditions. This does not mean that the DT&I Conditions were not appropriate when first imposed, or that they did not meet the legitimate standards of the public interest at the time they were imposed. It merely means that restrictions that are superseded by the changing nature of the public interest should be eradicated once they cease to serve the public interest.

The application of KCS' proposed rule to potential future rail mergers is relatively straightforward. As an example, in *UP/SP Merger*, the Board granted to Tex Mex trackage rights between Robstown/Corpus Christi and Beaumont via Houston, to make connections with

[12] Although the ICC's decision in *Traffic Protection Conditions* was later overturned on appeal (*Detroit, Toledo & Ironton R.R. Co. v. ICC*, 725 F.2d 47 (6th Cir. 1984)) because a case-by-case assessment, and not a blanket removal, of all past traffic protective conditions was required, the concept that DT&I Conditions conflicted with the evolved standard of the public interest was not overturned. KCS' proposal allows the Board to evaluate each past condition in the context of a newly proposed merger; no "blanket" removal of restrictions is urged.

KCS. These rights were imposed as a condition to in *UP/SP Merger* to replace competition between UP and SP that was eliminated by their merger, and to preserve the essential services of the Tex Mex. However, the conditional trackage rights were limited to overhead traffic "having a prior or subsequent movement on the Laredo-Robstown-Corpus Christi line." *UP/SP Merger* at 247. Of course, the adoption of such a restriction meant that Tex Mex could serve Houston shippers using its newly granted trackage rights, but it could only do so for traffic moving southbound. If a Houston shipper wanted to use Tex Mex for its northbound traffic, it could not. While KCS and Tex Mex believe such a restriction is overly narrow and prevents Tex Mex from being fully competitive, or from replacing competitive options lost in the UP-SP merger, nonetheless, at the time that these rights were imposed, the Board believed that the restriction, as described, was in the public interest.

If the modification to the Board's merger regulations proposed by KCS was adopted, UP would be required, in any subsequent rail merger where UP is an applicant, to (1) identify the existence of Tex Mex's trackage rights and restrictions, (2) analyze the continuing validity of the restrictions placed by the Board on those rights, in light of current merger policy and competitive and industry conditions, and (3) assess whether or not Tex Mex's restricted trackage rights could be modified to actually promote and enhance competition. All of this information would be contained in UP's merger application.

All parties to that merger proceeding could review UP's statements regarding Tex Mex's trackage rights, and would be free to comment on those statements, and to dispute them. Ultimately, as an element of its merger approval and upon request from any party to remove or modify the restriction placed upon Tex Mex's trackage rights, the rule would require a presumption in favor of the Board removing such a restriction. However, this would be a rebuttable presumption and UP could, upon presentation of evidence and argument, prevent the removal of the restriction if it established that retention of the restriction was in the public interest. As such, KCS' proposed rule does not dictate a given result. Instead, it provides for a rebuttable presumption that the removal of restrictions contained within previously imposed conditions is in the public interest in order to enhance and promote competition.

Conclusion

In summary, KCS believes that the Board's merger review authority would be improved if it included a standard review and reassessment of the restrictions placed on all merger conditions imposed in any prior merger involving the applicants. Such a review would further the evolving nature of the Board's public interest standard, and would eliminate the continuation of anticompetitive restrictions. Further, KCS believes that parties seeking to merge should bear the burden of establishing that any restrictions contained in their prior merger proceedings remain consistent with the public interest.

III. BENEFITS CLAIMED FROM PRIOR MERGERS SHOULD BE PRESERVED

Introduction

In its *ANPR*, the Board indicated that it would entertain proposals to eliminate the so-called "one case at a time" rule, currently codified at 49 C.F.R. § 1180.1(g) ("Section 1180.1(g)"). *ANPR* at 5. KCS fully supports the STB's inclination to eliminate this rule. Although the current regulation probably simplifies the Board's merger review process, and confines the issues addressed by parties participating in the merger proceeding, it also imposes an artificial limitation on the legitimate scope of the Board's inquiry into the furtherance of the public interest. Whatever benefits might arise from the voluntary "blinders" imposed by Section 1180.1(g) are more than offset by the fact that those "blinders" hide many of the likely impacts of proposed mergers. Therefore, despite the fact that elimination of the "one case at a time" rule will expand the scope of the merger review process, KCS firmly believes that potential is fully justified by the added perspective which will be gained through elimination of the rule.

Unfortunately, in considering the withdrawal of Section 1180.1(g), the Board may not have yet focused the additional methods of evaluating the potential downstream effects of a proposed merger. Specifically, in the *ANPR*, the Board discussed the potential for analyzing "the likely strategic responses to that transaction by non-applicant railroads." *Id.* In the opinion of KCS, purely focusing on the potential future reaction of other railroads (particularly where such reactions have not been made manifest, as in the filing of a notice of intent to file a control application under 49 C.F.R. § 1180.4(b)), may serve to ignore other effects. A singular emphasis on the "downstream effects" of a merger fails to take into account a more pressing and tangible matter: the impact which the merger is likely to have on benefits secured from prior mergers. In other words, in addition to reviewing downstream effects, the Board should also require that parties to any future merger proceeding examine the impact of their proposed transaction on the benefits to competition that they claimed in securing authority for prior mergers. These "cumulative impacts and crossover effects" will be more easily detailed because, unlike potential downstream effects, they currently exist, and their impacts can be identified, quantified and analyzed.

In reviewing merger applications, the Board should set as a minimum threshold the preservation of benefits conferred during the course of prior mergers.[13] Any merger that hampers

[13] KCS does not mean to limit the scope of "benefit" to those quantifiable "public benefits" relied upon by the Board in evaluating merger transactions. Instead, in the context of the proposed rule, the word "benefits" should mean all of the benefits claimed and relied upon to seek approval of a prior merger, whether or not such benefits qualified as "public benefits," resulting from an imposed condition or a private settlement agreement, or resulting from the nature of the transaction itself.

benefits achieved in a previous merger must either be denied outright, or conditioned to preserve the benefits of prior mergers. Compelling merger applicants to justify the impact which their merger will have on the benefits allegedly gained through their past mergers will ensure that the Board's efforts in preserving the public interest will not be mooted by subsequent proceedings.

Existing Regulation

The Board's current "one case at a time" rule states:

> *Cumulative impacts and crossover effects.* The Board recognizes that events can occur during its consideration of a consolidation that can have an effect on various of the concerned parties. However, the Board is mindful of the need to meet its statutory deadlines and make timely administratively final decisions. Therefore, the Board will not reopen pending proceedings in order to assess the impact of potential or hypothetical combinations or transactions. The proper forum for considering cumulative impacts and crossover effects is in a later proceeding. In this manner, consideration will be limited to the impacts of transactions which have already been approved and are, therefore, reasonably certain to occur. Furthermore, the Board will have the benefit of its findings from the prior proceeding to identify more precisely the impacts of that transaction. Proceedings will remain manageable in scope and size, statutory time limits will be met, and all parties will be assured of timely, administratively final decisions.

49 C.F.R. § 1180.1(g).

Proposed Modification To Existing Regulation

In place of the existing language of Section 1180.1(g), KCS proposes that the following language be substituted:

> *Cumulative impacts and crossover effects.* In every merger application constituting a "major" transaction under 49 C.F.R. § 1180.2, the applicants shall bear the burden of establishing that the proposed transaction will not have any adverse cumulative impacts or crossover effects on the benefits realized in prior merger proceedings involving any of the applicants, whether realized through conditions imposed by the Board on prior transactions, or through private agreements entered to further the benefits provided by the merger. To the extent that the applicants do not carry their burden of proof, the Board shall either deny authorization of the merger or condition its approval to protect and preserve all benefits realized in prior merger proceedings.

History Of The Existing Regulation

In its history, the ICC occasionally invoked the "one case at a time" rule, but its use has come under repeated criticism. In 1940, the Board of Investigation and Research found that "the disadvantages of developing policy through a sequence of limited cases are both numerous and impressive." *The Report On Practices and Procedures of Governmental Control*, 78th Congress, Second Session, House Doc. No. 678, at 81 (1944). Citing to this study in the course of overturning the ICC's original approval of the Penn Central merger, Justice Brennan commented that "a significant disadvantage is that individual proceedings 'seldom if ever produce sufficiently comprehensive records for the adequate solution of questions of major importance.' Obviously, without all of the relevant facts, the chance of a satisfactory disposition is diminished." *Baltimore & Ohio R.R. v. United States*, 386 U.S. 372, 431 (1967) (citation omitted) ("*Penn Central*"). Justice Douglas, in a dissent in the same case, also noted "the [ICC] has ample authority to insure a coordinated approach to railroad consolidations; it is not straightjacketed to a disjointed case-by-case approach." *Id.* at 441.

Perhaps because of these criticisms, or because of the practical limitations of ignoring external circumstances, the historic implementation of the "one case at a time" rule (as defined by the handling of "cumulative impacts and crossover effects") has not been consistent. The St. Louis Southwestern Railway ("Cotton Belt") purchase of the Rock Island's Tucumcari line contains a prime example. (*St. Louis Southwestern Rwy. Co. – Purchase (Portion) -- William M. Gibbons, Trustee Of The Property Of Chicago, Rock Island And Pac. R.R., Debtor*, 363 I.C.C. 323 (1980) ("*Tucumcari*"). In *Tucumcari*, the ICC at times appeared to address the cumulative effects of the proposed line purchase:

> Cumulative impacts.--Although most of the empirical analysis in consolidation proceedings assumes a static base year, we must consider certain changed

> circumstances. One such change would be our recent decision in Burlington Northern, Inc.--Control & Merger--St. L., 360 I.C.C. 788 (1980). Should that merger be consummated, the cumulative impacts of that merger and this acquisition will be felt by certain carriers, especially [Missouri-Kansas-Texas Railroad] ("MKT") and CNW. *Id.* at 355.
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> * * *
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> [W]e conclude that the cumulative impacts of the two proceedings will not affect either MKT's or CNW's abilities to provide essential services. *Id.*
>
> * * *
>
> Thus, the cumulative impacts of these two transactions have been considered and we find that there will be no affect [sic] on any carrier's ability to provide essential services. *Id.* at 356.

Tucumcari at 355-56.

At other points in *Tucumcari*, however, the Commission indicated that it would be inappropriate to consider the impact of matters external to the contemplated transaction:

> On May 15, 1980, 6 days after the oral argument was heard, SP announced its intention to merge with Santa Fe Industries ... CNW believes that we must reopen the record in order to consider the ramifications that planned merger will have on the current proceedings ... A fundamental problem in CNW's motion is that it requires us to foretell the future. We have before us in these proceedings SP's application to acquire the Tucumcari line, not its application to merge with ATSF. In fact no such application has been filed. Even if such an application is filed as expected, by the end of the year, it would probably be at least another year before a final Commission decision might be made on that application. Further, we cannot now speculate what that decision might be ... Every time a proposal is announced which might eventually affect an ongoing proceeding we cannot reopen the current proceeding. Were we to do so, final decision might never be forthcoming. The administrative process would be incapacitated. Therefore, we must limit our consideration to the transactions before us and we must consider the consequences of those transactions only, not the possible effects of hypothetical mergers ... In conclusion, our decision to approve SP's purchase of the Tucumcari line was based on a thorough review of the voluminous record in this proceeding. We believe it to be contrary to the public interest and our congressional mandate to delay a proceeding to consider hypothetical future mergers. The issues raised by CNW, which deal with the ramifications of a possible SP-ATSF merger, will be decided at the proper time on the basis of an appropriate and complete record.

Tucumcari at 409-410.

Shortly after issuance of the *Tucumcari* decision, the ICC issued a notice of proposed rulemaking (*Railroad Consolidation Procedures, General Policy Statement*, Ex Parte No. 282 (Sub-No. 6), 363 I.C.C. 241 (1980), in which it proposed to adopt a rule substantially in the form of the current "one case at a time" rule to generally prohibit the review of matters outside of the current docke . In proposing the rule, the ICC said:

> Section (g), cumulative impacts and crossover effects, is a new section which discusses the problem of deciding consolidation proceedings in an ever-changing environment. In [*Tucumcari*], we explained that the best approach is to deal with these effects on a case-by-case basis. We will not reopen pending proceedings to assess the impact of potential consolidations. Rather, we will consider the cumulative impacts and crossover effects in the later proceedings, where we will have the benefit of our previous findings. In this way the proceedings would remain a manageable size and scope, existing statutory time limits would not be disturbed, and timely administratively final decisions w ·ld be issued.

Id. at 243.

Apparently, the ICC's proposed rule was not very controversial, because:

> [o]nly BN commented on this section. Although it disagreed with our suggested approach of considering cumulative impacts and crossover effects in the later proceeding rather than reopening prior proceedings, BN could not suggest a suitable alternative approach. Neither can we. Our policy in this area was formulated only after a great deal of thought was given to the problem. We see nothing in the comments that calls for a modification in the proposed section.

Railroad Consolidation Procedures, General Policy Statement, Ex Parte No. 282 (Sub-No. 6), 363 I.C.C. 784, 790 (1981).

Since its adoption in 1981, the language of the regulation has not changed in any substantive way.[14] In several instances since adoption of the regulation, the ICC and the Board have found occasion to invoke the "one case at a time" rule . *See, e.g., Chicago and N.W.*

[14] In 1982, Section 1111.1(g) was renumbered to become what is today Section 1180.1(g) and in 1997, all references to the ICC were changed to reference the STB.

Transp. Co. – Constr. and Operation of a Line of R.R. in Niobrara and Goshen Counties, Wyo. and in Sioux and Scotts Bluff Counties, Neb., 363 I.C.C. 906, 932-33 (1981). ("We cannot presume that the [UP-MP-WP] merger will be approved, or, if so, what protective conditions might be imposed; therefore, evidence relating to the effects of that proposed merger would be purely speculative.").

Impact Of The Proposed Modification

The impact of the modifications proposed by KCS would be quite minor. Essentially, the Board's current regulation at Section 1180.1(g) would be transformed from a rule of exclusion into a rule of inclusion. With the modification, all merger applicants would be required to include in their application a new section listing the benefits, public or private, which were promised in every prior merger proceeding involving any of the applicants, along with an assessment of the impact of the current transaction on those prior merger benefit, and a suggestion for conditions to preserve those prior merger benefits to the extent that they would be diminished by the instant transaction. The burden of proof would rest on the applicants to establish that their suggested condition(s) would in fact remedy the diminution of prior merger benefits occasioned by their current merger. Interested parties would then have the opportunity to comment on both the harm which the merger under consideration would cause to prior merger benefits and the applicability of the proposed remedial condition. Ultimately, the Board would decide whether a merger under review would adversely impact prior merger benefits, and if so, what conditions are needed to preserve those benefits.

Justification For The Proposed Modification

The justification for KCS' proposed modification is quite simple: a party should not be allowed to secure the Board's merger authority by trumpeting the benefits to be conferred in a merger, only to trample on those benefits in a subsequent merger. If mergers are to produce the benefits claimed by their proponents (such as single-line service, or reduced transit times, or increased access, or improved market reach), those benefits cannot be expediently forgotten in the quest for another merger.

KCS agrees with Justice Brennan that a case-by-case approach seldom produces a "sufficiently comprehensive record[] for the adequate solution of questions of major importance." *Penn Central* at 431-32. Eliminating the one case at a time rule is thus the first step toward modernizing the STB's approach to rail consolidation proceedings. However, eliminating a rule is much easier than determining just how the STB should analyze future merger proceedings and determining what type of evidence parties should submit to ensure a fully comprehensive record, including potential crossover and cumulative effects.

KCS fully expects that other parties to this proceeding will be proposing rule changes that focus on potential future transactions that would be triggered by approval of the instant transaction, and KCS may be willing to support such proposed rule changes. KCS suggests, however, that the Board not only focus on the downstream effects of a proposed transaction but should also review the preservation of benefits conferred in previously approved transactions. Merger applicants should be required to disclose information that will allow the Board to consider whether the proposed transaction has an impact upon the benefits that were achieved, or at least promoted, by one of the applicants in previously approved transactions. In this way, KCS believes that the Board's inquiry should also be directed toward preserving the benefits achieved in the past, rather than on imposing conditions based upon speculative notions of where the industry is going. While an assessment of the impact on prior merger benefits sometimes occurs under the existing standards, the current approach relies exclusively on commenting or opposing parties to bring up such prior benefits and to establish that such benefits will be adversely impacted. KCS suggests that this burden more properly belongs on the parties attempting to establish that their merger is in the public interest.

The Board should therefore add a requirement that all merger or control applications include a disclosure and discussion of the manner in which the proposed transaction would reduce, modify, change, or otherwise impact the benefits realized from a previously approved transaction, regardless of whether those benefits were achieved through conditions imposed by the Board, through private agreements, or merely part of the Board's overall public interest consideration of the prior merger. If such prior benefits would be impacted, applicants should be required to include, as a part of their merger or control application, offsetting conditions to ensure that all such benefits from prior approved mergers will not be adversely impacted. If the applicants do not adequately address anticipated merger impacts, the Board should deny the application or impose conditions to preserve and protect prior merger benefits.

KCS' approach is entirely reasonable and consistent with the Board's broad statutory obligations:

> The Act's single and essential standard of approval is that the [Board] find the [transaction] to be 'consistent with the public interest.' In determining the public interest, we balance the benefits of the merger against any harm to competition, essential service, labor, and the environment that cannot be mitigated by conditions.

CN/IC Merger Decision at 19 (citations omitted).

Moreover, the change proposed by KCS would not represent a radical departure from the current process by which the Board addresses harms likely to be caused by proposed mergers. Currently, third parties are compelled to appear before the Board and bring to the Board's attention instances in which a proposed merger would reduce or eliminate competition, and to seek either denial of merger authority or the imposition of ameliorative conditions.[15] Under KCS' proposal, the burden of coming forward with instances where a proposed merger would diminish previously-recognized public benefits would fall on the applicants. Once the issue is identified and presented in a merger application, the Board would continue to follow its established process for determining the extent of the harm, and the ability of the proposed condition to cure the harm.

It is entirely appropriate that parties seeking to merge should bear the burden of maintaining the viability of pre-established benefits. The new rule would require applicants to account only for those benefits that emanated from their own previous transactions. The change is therefore of limited scope. Additionally, parties will only be required to continue the benefits they promoted in prior cases. The "burden" placed on applicants is merely one of consistency. Moreover, the applicants, and not third parties, are in the best position to know what benefits resulted (or were promised) from their prior transactions, and what impact the proposed transaction will have on those benefits. Finally, by shifting the burden to applicants, the newly-generated information will be contained in the merger application. The issue of harm to prior merger benefits will therefore be raised earlier in the merger proceeding, and KCS' proposed new regulation should therefore shorten, not lengthen, the process of regulatory review.

KCS is able to offer several concrete examples of how the changes it proposes to the Board's treatment of harm to recognized benefits would operate in actual merger settings. In the merger of CN and IC, KCS and the applicants had negotiated two separate agreements as settlements to KCS' concerns about the merger -- the aforementioned Alliance Agreement and

[15] "Conditions will generally not be imposed unless a merger produces effects harmful to the public interest that a condition will ameliorate or eliminate. The principal harms for which conditions are appropriate are a significant loss of competition or the loss by another rail carrier of the ability to provide essential services." *CN/IC Merger Decision* at 21.

the Access Agreement. Both agreements provided benefits to KCS, the applicants, and the public interest. The Access Agreement provided for KCS access, through haulage rights, to three shippers in the Geismar, Louisiana area. While this was a privately negotiated agreement, the Board nonetheless imposed the Access Agreement as a condition to the merger and required the Applicants to extend the scope of KCS' access to three other Geismar shippers. In so doing, the Board found this to be in the public interest and stated:

> The Board is also granting haulage rights to KCS over IC's line to serve three additional shippers at Geismar, LA. Because of this merger and its related Access Agreement, it is unlikely that any Geismar construction project will occur even though KCS has previously requested our regulatory approval for such construction. This loss of the build-in/build-out option by the three shippers could have a significant adverse effect on potential competition in the area. Accordingly, the Board's grant of haulage rights to KCS is in the public interest because the Geismar condition is intended to preserve these shippers' pre-merger competitive position.

CN/IC Merger Decision at 62 (Comments of Vice Chairman Clyburn).

As applied to the example used above, if the proposed consolidation between BNSF and CN were to go forward, those parties would be required, under KCS' proposed rule, to list in their control application KCS' haulage rights in the Geismar area as a benefit of a previously approved transaction in which one of the applicants (CN) was involved. They would then have to discuss whether or not the BNSF/CN transaction would modify or impact KCS' haulage rights, *i.e.* would the proposed BNSF/CN transaction change the service schedules, crew assignments, rates, or terms and conditions or public benefits of the haulage condition. If BNSF and CN believed that their transaction would have no impact upon the Access Agreement imposed in the CN/IC transaction, they would be required to list the condition and explain why they do not feel any proposed mitigation is necessary to preserve that public benefit.

If the BNSF/CN transaction would impact KCS' haulage rights imposed in the CN/IC transaction, BNSF and CN would be required to explain that change and to offer proposed mitigation to offset that impact. The proposed mitigation could be in the form of a negotiated solution with KCS, the Geismar shippers, or another proposed solution. The intent of the proposed mitigation would be to ensure that the public benefits resulting from the CN/IC transaction were not eliminated by the BNSF/CN transaction. The proposed mitigation would be set forth in the control application. Under KCS' proposed rule, all parties would thus be allowed to see the problem, see the proposed solution, and comment upon the proposed solution. The Board could then make a finding based upon evidence and the public record.

Conclusion

Although KCS supports the Board's suggestion that it begin considering "downstream effects" as an element of its standard merger review, KCS believes the public interest would also be served through preservation of benefits derived from prior mergers. KCS therefore proposes a modification to the Board's current merger review regulations that would protect all benefits claimed from prior merger proceedings. The burden of proposing suggested conditions to protect past benefits properly would be shifted under the rule to the parties proposing yet another merger. This change will not result in a significant additional burden to merging parties, and may in fact shorten the merger review process, as the new regulation would focus all parties earlier in the proceeding on potential harm to the public interest.

IV. APPLICANTS SHOULD BE REQUIRED TO DISCLOSE AND DISCUSS THE IMPACT OF RELATED NEGOTIATED AGREEMENTS IN MERGER PROCEEDINGS

Introduction

The Board's proceedings and decision in *Public Views* and in this proceeding acknowledge the need for amplified examination of the overall competitive impact of major mergers. *See ANPR* at 4. In accord with that recognition, the Board should require that applicants in major consolidation transactions submit to the Board (subject to applicable protective conditions) copies of all settlement agreements entered with any party and an analysis of the impact of that settlement on the proposed transaction. All other parties should be given thirty days for discovery and to file evidence and comments responding to the settlement. The Board's final decision on the application should then address the impacts of those agreements. This modest procedural change is necessary to enable the Board to make a more fully-informed decision on the impact of major transactions.

Existing Policy

Current Board policy does not require submission to the Board of settlement agreements in major consolidation proceedings. Neither are applicants required to present any analysis or public interest justification for a settlement. In practice, applicants submit only those settlements that they believe are essential to getting Board approval of the transaction. Too often, these agreements are concluded late in the proceeding, up to and including at oral argument. Even if the applicants choose to disclose the terms of the settlement, that information comes too late for analysis of the settlement or of its effects on the public interest.

That applicants choose to protect some of their settlement agreements from the Board's review should, in itself, give the Board concern. Are major merger applicants engaged in mere horse-trading that does not serve the public interest? At present, the Board does not have sufficient information to reach an informed conclusion. Moreover, the competitive impacts of settlements cannot be assessed if the contents of the settlement agreements are not revealed. KCS' proposed requirement to disclose and explain settlements in major consolidations would stop this practice of hidden tradeoffs and unknown impacts. It would be only a modest procedural change in the interest of full disclosure on competition issues.

Proposed Modification To Existing Regulation

This proposal would add new provisions as 49 C.F.R. § § 1180.3(i) ("Section 1180.3(i)") and 1180.4(e)(2) ("Section 1180.4(e)(2)"), renumbering subsections currently bearing those numbers and subsequent subsections accordingly. New Section 1180.3(i) would define "settlement agreement" as follows:

> (i) *Settlement agreement.* As used in this Part, "settlement agreement" means any agreement or understanding that is -
>
> (a) reached by one or more applicants
> (b) with any person (as defined in 1 U.S.C. § 1),
> (c) by which any party thereto intends to create any legally enforceable obligation, and
> (d) by which any applicant intends to reduce opposition to or increase support for the transaction application, or to facilitate applicants' post-transaction operations,[16]
>
> whether or not such agreement or understanding is executed as a written contract. Without limiting the applicability of the foregoing, any agreement reached by an applicant with a party that either (1) issues or has issued a press release, or (2) files or has filed any statement with the Board opposing a proposed transaction after the prefiling notification of that transaction has been submitted under Section 1180.4(b), shall be considered a settlement agreement. Also, any agreement implicitly or explicitly requiring the non-applicant party or another person subject to its control to support or not to oppose the transaction application, or that

[16] *See generally CN/IC Merger*, Decision No. 12, Slip. op. at 4 (STB served Oct. 16, 1998) (stating that the fact that "the Alliance and Access Agreements were intended to settle any grievances KCS might otherwise have expresses vis-à-vis the CN/IC application" was sufficient to qualify those agreements as settlements with CN and IC).

contains conditions that are effective only if the Board approves the transaction or if the transaction is consummated by the applicants, shall be considered a settlement agreement.

New Section 1180.4(e)(2), governing evidentiary proceedings, shall also be added, providing as follows:

(2) (i) Applicants have a continuing obligation to file with the Board copies of all settlement agreements as soon as practicable following completion of such agreements. Such agreements may be submitted under any applicable confidentiality provision authorized by the Board, provided at least that outside counsel and consultants for parties shall be able to review the entire agreement.

(ii) Applicants shall submit with the agreement a detailed analysis of the impacts of such agreement on the pending transaction, including projected traffic diversions, projected traffic flows, operating schedules, an implementation plan, and a full discussion of the environmental, labor, and safety impacts of the agreement.

(iii) Notwithstanding subsections (c)(4), (d)(3) and (e)(3) of this Section, parties to the proceeding shall have a minimum of 30 days to conduct discovery and submit comments and requests for conditions relating to each settlement agreement filed. Should the applicants file a settlement agreement less than 30 days prior to the Board's scheduled voting conference, such submission shall be treated by the Board as a petition by the applicants to modify the procedural schedule to allow 30 days for discovery and comment on the settlement submitted.

(iv) Terms and conditions of settlement agreements shall become part of the record in the Section 11323 transaction and shall, if requested by any party, be subject to modification by the Board or imposition as a condition to the approval of such transaction.

Impact Of The Proposed Modification

The proposed rule will require a simple disclosure and explanation of each settlement entered by applicants in major consolidations, and will enable other parties to respond, in order to give the Board full information on the impact of a proposed consolidation. The requirement is procedural in nature; it does not require that the Board approve or disapprove settlements presented or incorporate them into its decision. Rather, it simply requires presentation of information by applicants and by other interested parties, about the effect of proposed settlements. In this way, the Board will both know the full impact of its decision and be better able to protect the public interest in the merger transaction.

Justification For The Proposed Modification

The Board has recognized the need to look to issues beyond those that its major merger decisions have historically addressed in order to preserve and perhaps enhance competition in the rapidly consolidating Class I rail market. *See generally ANPR* at 7. To carry out its mandate under 49 U.S.C. § 11324(c) to protect the public interest, the Board needs to consider how settlements relating to major consolidations affect the public interest. The Board cannot perform that task without adequate information. This proposed rule is intended to aid the Board in that effort by requiring disclosure and development of relevant facts about settlements in major mergers.

Settlements in major merger cases clearly can affect the public interest. Indeed, carriers such as UP, SP, CSX, NS, CN, IC and Conrail all have used settlements to remedy problems with their transactions. *UP/SP Merger* was bolstered by major settlements with BNSF and Chemical Manufacturers Association ("CMA"), designed to fix competitive problems. The CSX and NS division of Conrail was supported by settlements with National Industrial Transportation League ("NIT League") and National Rail Passenger Corporation ("Amtrak"), among others. And the CN-IC transaction was supported by settlements with KCS and NIT League. Each of these agreements contributed somehow to ameliorating problems with or adding benefits to the transactions originally planned by the applicants. This clearly shows that settlements can affect the public interest in major consolidation transactions.

But what of the settlements that were reached yet were not presented to the Board? Identifying them is, of course, very difficult, but few would argue that they don't occur. Each of these "hidden" settlements has the potential to affect traffic flows and other such issues - issues that the Board's current regulations require applicants to address in their applications. *See* 49 C.F.R. § 1180.8(a). However, applicants presently need not address these issues with respect to settlement agreements.[17] Haulage arrangements, as an example, do not require Board approval. Therefore, settlement agreements based on haulage would not have to be submitted to the Board. Nevertheless, such agreements could significantly affect traffic flows.[18] And while the Board's Section of Environmental Analysis has required parties to submit environmental reports concerning some settlements, *see, e.g., UP/SP Merger*, Decision No. 28, Slip op. (STB served March 29, 1996), such requirements applied to transactions within the Board's jurisdiction (*e.g.*, trackage rights),[19] and did not address the settlement's competitive effects. Thus, absent a requirement for full disclosure and analysis, such as is proposed in the suggested rule, major merger applicants can enter settlement agreements that would significantly affect post-transaction operations without any scrutiny of those agreements by the Board. While it may be in the applicants' interest to present those agreements that provide additional public interest justification for their applications, what of other settlements? What is their effect on the public interest?

[17] *See, e.g., UP/SP Merger*, Decision No. 30, Slip op. at 3 (STB served April 18, 1996) (a party to a settlement does not become an applicant by virtue of the settlement) and *UP/SP Merger*, Decision No. 35, Slip op. at 3 (STB served May 9, 1996) (applicants not required to amend application to include effects or modifications to settlement discussed in the application).

[18] Haulage rights can have tremendous effects on traffic flows. CNW's haulage service for UP prior to the UP-CNW merger involved what UP termed "the largest single rail traffic interchange in the U.S."

[19] *See generally* 49 C.F.R. § 1105.5.

An instructive example of the need for the proposed rule is the treatment of KCS' Alliance Agreement in the CN-IC merger. In that proceeding, KCS entered a two-part settlement with the merging carriers. One part of the settlement involved a grant of trackage rights, conditioned on CN and IC consummating the merger. KCS wanted that portion of the settlement imposed as a condition on approval of the merger. The second part involved various marketing and other cooperative arrangements that were not subject to the Board's jurisdiction. *CN/IC Merger Decision* at 31. Accordingly, CN, IC and KCS were not required to submit that agreement.

Although submission of the Alliance was not required, its consideration by the Board significantly advanced consideration of the overall effect of the CN-IC application. Several parties argued that the Alliance Agreement would restrict competition. They therefore sought discovery and submitted comments addressing the Alliance portion of the overall KCS-CN-IC settlement. The Alliance thus became part of the record before the Board, and the Board addressed competitive and other effects of the Alliance in its decision approving the CN/IC merger. *Id.* at 24-31.

The Alliance was more thoroughly considered, debated and analyzed than many settlements entered in major consolidation proceedings. While the Alliance was in some respects typical of settlements in major rail mergers, it was unusual in that the CN-IC application addressed it, enabling parties to obtain discovery of it. *See CN/IC Merger*, Decision No. 12, Slip op. (STB served Oct. 16, 1998). In other contexts, apparent settlement agreements have been effectuated through separate exemption proceedings largely preventing discovery. *Compare Conrail Merger Decision* at 223-225 (describing the desire of Reading, Blue Mountain & Northern Railroad ("RBMN") for a connection to Delaware & Hudson Railway ("D&H")) *with*

Delaware & Hudson Railway—Acquisition and Operation Exemption—Consolidated Rail Corporation, STB F.D. 33595, 1998 STB LEXIS 181 (STB served July 15, 1998) (creating a connection between RBMN and D&H outside of the NS-CSX-Conrail proceeding). When merger-related settlements are effectuated outside the merger proceeding, the Board's ability to analyze that settlement's effects is compromised.

The Board's consideration of a settlement's effects also often is compromised when the settlement is reached late in a merger proceeding. When late settlements occur, the parties' ability to present the Board with comprehensive and coherent evidence and comment on the effect of the settlement is significantly impaired. Two excellent examples of this are the CMA settlement in the UP-SP proceeding and the NIT League settlement in the CN-IC proceeding. In the former case, the UP-SP application was heavily dependent on the applicants' settlement with BNSF to ameliorate broad anticompetitive effects of a consolidation of largely parallel systems. In mid-April 1996, nearly five months after the UP-SP application was filed, the CMA settlement was filed modifying the BNSF agreement. Subsequently, UP and SP submitted at least two additional sets of modifications to the BNSF agreement, the last set being filed after briefs were filed in the case. *See UP/SP Merger Decision* at 243. As a consequence, parties were denied opportunities for full discovery, analysis and presentation of evidence about the CMA agreement. *See UP/SP Merger*, Decision No. 38, Slip op. at 5 (STB served May 31, 1996) (confining parties submissions about the CMA settlement to briefs).[20] Nevertheless, the Board admitted that there were "unresolved issues" concerning the CMA agreement. *Id.* Whether resolution of those issues would have affected the CMA's eventual need to join the Consensus Parties in seeking further conditions on the UP-SP merger in 1998 cannot be known.

[20] For a similar result, *see Conrail Merger*, Decision No. 64, 1998 STB LEXIS 20 (STB served Jan. 29, 1998).

The CN-IC proceeding also involved a last minute settlement. "On the day before oral argument," the Board wrote, "NIT League and applicants submitted a stipulation and agreement and requested that we approve that agreement as a condition to our approval of this transaction." *CN/IC Merger Decision* at 31. While another shipper group joined that request, the Department of Transportation expressed doubts about according the agreement antitrust immunity inherent in Board approval. Unable to find strong reasons to make the NIT League agreement a condition, and in light of DOT's doubts, the Board denied the condition. *Id.* at 32. Again, apparently left in some doubt about the effects of the agreement, the Board's decisionmaking was compromised.

Consistent with the Board's recognition in *Public Views* that it needs to look at competitive issues in major mergers more proactively, this proposed rule requires the applicants to affirmatively and promptly disclose settlements and their effects, and allows a limited period for evidentiary development and comment on such settlements. Not only will this promote more complete disclosure, but it also will eliminate a good deal of procedural maneuvering (*e.g.*, discovery) which consumes vast resources of parties and the Board in merger cases. *See generally CN/IC Merger*, Decision No. 12, Slip op. (STB served Oct. 16, 1998) (appeal of ALJ order allowing access to certain settlement-related information).

The proposed rule would be consistent with existing Board policies. First, it does not discourage settlements. The Board has said repeatedly that it favors settlements. *See, e.g., Conrail Merger Decision* at 58 ("[W]henever possible, disputes should be resolved by negotiated settlement between affected parties, rather than addressed by resolution imposed by a government decree."). *See also* 49 U.S.C. § 10101(2) (national rail transportation policy provision encouraging minimizing regulatory control of the rail system where possible). The proposed rule does not discourage settlements, but instead merely requires their disclosure.

While this might discourage applicants in major consolidation transactions from entering settlements that would not withstand public interest scrutiny, such settlements should be discouraged. It cannot be said that the negotiation and consummation of a settlement agreement, even a settlement agreement that purports to resolve competitive concerns, is necessarily in the public interest. Yet, the current process, which does not call for disclosure and discussion of settlement agreements, exhibits such a belief. It is the Board's duty to protect the public interest in consolidation transactions, not to foster private deals by the applicants that potentially hurt the public interest.

In addition, the proposed rule is consistent with the settlement privilege recognized by the Board. The Board has recognized a settlement privilege in major consolidation transactions. *See, e.g., CN/IC Merger*, Decision No. 12, Slip op. at 7 (STB served Oct. 16, 1998). However, that privilege does not completely shield a settlement from disclosure. Rather, "the settlement privilege that has been recognized in [Board] precedents would bar discovery, by opposing parties, of confidential material related to the negotiation" of the settlement agreement, absent exceptional circumstances. *Id.* Likewise, the proposed rule requires disclosure only of the settlement itself and requres a discussion of the settlement's impacts on the proposed transaction. The proposal does not mandate that the Board do anything more than consider the agreements submitted. The proposal does not require disclosure of the details of the negotiation or give and take, but simply the agreement itself. Accordingly, the proposal does not violate the settlement privilege that ordinarily protects against forced disclosure of negotiations underlying settlements.

The rule also establishes a minimal period for discovery and comment on settlements filed with the Board, regardless of when (before the final decision) the settlement is filed. In both *UP/SP Merger* and *Conrail Merger*, there were substantial disputes over parties' ability to present evidence concerning a late-filed settlement. *See, e.g., UP/SP Merger*, Decision No. 38, Slip op. (STB served May 31, 1996), and *Conrail Merger*, Decision No. 64, 1998 STB LEXIS 20 (STB served Jan. 29, 1998). The proposed rule would eliminate this ground of dispute by allowing a minimum 30-day period for discovery and comment on settlements. To be consistent with statutory requirements limiting the time for development of the evidentiary record and issuance of a final decision, however, the rule treats any settlement filed less than 30 days before the Board's scheduled voting conference on the application as a petition by the applicants for an extension of the procedural deadlines. In some proceedings, the Board's procedural schedule has not utilized the entire time allowed by statute for handling a major application. *See* 49 U.S.C. § 11325(c). Thus, the Board could easily extend the schedule on late filing of a settlement. However, should extending the procedural schedule 30 days run afoul of the statutory deadlines, the Board would be well within its powers, either on its own initiative or on the basis of applicants' request implicit in filing a settlement, to extend that deadline under the 49 U.S.C. § 10502 exemption power.

Some may argue that the 30-day response period will discourage settlements and delay timely decisionmaking. However, applicants clearly will prefer to file their settlements more than 30 days before the voting conference, to avoid delaying the outcome of their application. Rather than discouraging settlements, the rule would provide some certainty in the process so that parties and the Board were not constantly trying to get a grip on a changing shape. Encouraging applicants' timely completion and filing of settlements will foster timely decisionmaking as well as the Board's fully-informed examination of a settlement's effects. Such a fully-informed examination serves the public interest.

The proposed rule will foster full disclosure and deliberate consideration of the impact on the public interest of merger settlement agreements. As with the Alliance Agreement, bringing settlement agreements to light and debating their impact on the public interest is necessary to making a complete analysis of the transaction for which they are entered. As noted earlier, while the Board was able to conclude that the Alliance would not be anticompetitive, some settlements may not be so be[illegible] example, perhaps CMA's participation as a Consensus Party in the UP/SP Houston/Gulf Coast Oversight proceeding shows that its hastily considered settlement (struck near the end of the *UP/SP* transaction) did not go far enough.

Conclusion

Requiring merger applicants to disclose the side deals they have made to eliminate opposition to their application is crucial to accurate assessment of the true overall effect of a proposed merger. Without such a requirement, the Board's decision on the merger transaction is less than fully-informed, and fails to explore the full ramifications of the Board's requested approval. In order to reach farther to preserve and promote competition in a consolidating market, the Board should take the reasonable, moderate step of imposing this proposed rule.

V. RECENT CANCELLATIONS OF RECIPROCAL SWITCHING ACCESS SHOULD BE DISCLOSED AND DISCUSSED

Introduction

In the *ANPR*, the Board stated that "the time has come to consider whether we should alter our rail merger policy to place a greater emphasis on enhancing, rather than simply preserving, competition." *ANPR* at 7. The Board specifically cited mandatory reciprocal switching, where merger applicants would be required to provide switching, at an agreed-upon fee, to all exclusively served shippers located within or adjacent to terminal areas, as one issue suggested for consideration in the competition enhancement debate. In acknowledging this suggestion, the Board noted that the suggestion, as proposed, was even broader than the reciprocal switching conditions that the Board imposed in the *Conrail Merger*. *Id.*

KCS opposes adoption of a broad rule mandating reciprocal switching. KCS believes such a broad rule, even in the context of a merger, would detrimentally change the Board's longstanding *Midtec* precedent, which governs the method and means by which a captive shipper is entitled to mandatory reciprocal switching. *See Midtec Paper Corp. et al. v. Chicago and N.W. Transp. Co. (Use of Terminal Facilities and Reciprocal Switching Agreement),* 3 I.C.C.2d 171, 173-174 (1986), *aff'd*, 857 F.2d 1487 (D.C. Cir. 1988) ("*Midtec*"). Nonetheless, KCS is mindful of the concerns expressed by exclusively served shippers and believes that some changes in the rules governing the treatment of such shippers in the context of a merger proceeding is warranted. To this end, KCS supports a change in the merger rules that would require the disclosure by merger applicants of any facility, station, or terminal that had been closed to reciprocal switching by any of the applicants within 24 months prior to the filing of the notice of intent to merge pursuant to 49 C.F.R. 1180.4(b). The proposed rule would create a rebuttable presumption favoring resumption of reciprocal switching upon request by a party in the merger proceeding. An applicant could overcome the presumption by showing that the substantial public interest supports keeping the facility, station, or terminal closed. As will be shown below, the reciprocal switching revision as proposed by KCS provides a careful balance of continuing and enhancing competition without over-reaching and forcing access where none had previously existed.

In essence, KCS' proposed rule on reciprocal switching only minimally enhances competition while carefully preserving competition for those shippers that recently lost access to another carrier or carriers due to reciprocal switching cancellation. As a result, the reinstatement of reciprocal switching merely preserves for those shippers the number of carriers that had traditionally served that shipper and that status would have been destroyed by the canceled reciprocal switching. Limiting the reinstatement to the 24-month period prior to the filing of a notice of intent under 49 C.F.R. 1180.4(b) provides a definite and reasonable time period for the reinstatement. Furthermore, instituting a rebuttable presumption in favor of reinstating the reciprocal switching gives the Board flexibility when special circumstances are shown by applicants to overcome the presumption. Foremost, providing this relief only in the context of a merger, without the showing of competitive harm, provides the important balance KCS believes is necessary during this rulemaking process.

Existing Policy

The proposed merger rule requiring disclosure of instances where reciprocal switching access has been canceled by a merger applicant within two years of its filing of a notice of intent to file a merger application is in the public interest. To better understand why the proposed merger rule is in the public interest it is helpful to understand the historical development of the Board's current view on access under the reciprocal switching statute. Under the Interstate Commerce Act ("ICA"), as amended by the I.C.C. Termination Act of 1995 ("ICCTA"), the STB "may require rail carriers to enter into reciprocal switching agreements, where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service." 49 U.S.C. § 11102(c)(1). Prior to the mid-1980s, the ICC engaged in an inquiry into the broad public interest considerations underlying a grant of terminal trackage rights or reciprocal switching.[21] This test was later clarified to include an examination of the interests of the particular shippers, located at or near the terminal involved, balanced with the interests of the carriers and of the general public. For example, in *CSX/Chessie Merger*, the ICC looked at the various interests implicated in granting rights to a terminal facility, including the shippers, the carriers, and the citizens of the town, and engaged in a "balancing" of those interests. *CSX/Chessie Merger* at 584-586 (1980).

Beginning in 1985, the Commission undertook to alter its broad public interest analysis under 49 U.S.C. § 11102(c) in the context of reciprocal switching access cases. In *Intramodal Rail Competition*, 1 I.C.C.2d 822 (1985), *aff'd sub nom. Baltimore Gas and Elec. v. United States*, 817 F.2d 108 (D.C. Cir. 1987), ("*Intramodal*"), the Commission adopted rules to govern competitive access issues for joint rates and reciprocal switching. As applied, the rules focus upon whether or not the owning carrier has engaged in anticompetitive conduct, such as the classic categories of competitive abuse: foreclosure; refusal to deal; price squeeze; or any other recognizable forms of monopolization or predation. The purpose of the rules is to provide guidance on the type of evidence required, and to make clear circumstances under which the Commission would prescribe reciprocal switching. The *Intramodal* decision by design applied only to reciprocal switching. However, in *Midtec*, the Commission extended the *Intermodal* rules to also apply to applications for terminal trackage rights under 49 U.S.C. § 11102(a). Thus, parties seeking prescription of reciprocal switching had to meet the relatively stringent *Midtec* test.

[21] Access under terminal trackage rights and reciprocal switching fall under the same test for determining whether to grant such access rights, however, reciprocal switching is generally thought of as a less intrusive form of access than terminal trackage rights.

Under the *Midtec* public interest test, the burden of pr. of is on the movant to show that the line owner has engaged in or is likely to engage in anticompetitive conduct. *Midtec* at 181-82. The essential questions on this point are: (1) whether the railroad has used its market power to extract unreasonable terms on through movements; or (2) whether because of its monopoly position the carrier has shown a disregard for the shipper's needs by rendering inadequate service. *Id.* Since its adoption, the *Midtec* anticompetitive conduct standard has been applied consistently to applications under 49 U.S.C. § § 11102(a) and 11102(c) with the result that few requests have been granted. The competitive access rules that determine whether reciprocal switching will be prescribed were codified at 49 C.F.R. Part 1144. Significantly, the rules require that the conduct of the line owner be scrutinized from a competitive standpoint and that anticompetitive behavior on the part of the defendant railroad be shown before reciprocal switching will be prescribed.

Nevertheless, in several merger cases culminating with *UP/SP Merger*, the Board made clear that in a merger proceeding the Board will apply the broad "public interest" standard to applications under 49 U.S.C. § 11102 ("Section 11102") and not the *Midtec* anticompetitive conduct standard. The ICC, and later the Board, has found in the context of merger cases that the grant of access rights under Section 11102 will be in the public interest in a number of different circumstances. These circumstances include granting Section 11102 rights in order to: (1) ameliorate a harm or anticompetitive effect created by the merger, *UP/MP/WP Merger*; (2) implement a condition imposed by the Board, *Denver and Rio Grande W. R.R. et al. v. St. Louis Southwestern R.R.*, I.C.C. F.D. 30759, 1987 ICC LEXIS 488 (ICC decided January 5, 1987); (3) supply short missing links between merging carriers, *UP/SP Merger;* or (4) implement privately negotiated settlement agreements as part of a merger proceeding, *CSX/Chessie.*

Most recently the STB expanded the imposition of reciprocal switching in the context of a merger in *Conrail Merger*, in which the Board granted relief in several variations with respect to reciprocal switching. First, the Board expanded the NIT League settlement agreement to include the preservation of reciprocal switching agreements in both directions, *i.e.* both agreements that Conrail made available to NS and CSX and agreements that NS or CSX made available to Conrail. The NIT League agreement without the Board's modification only protected reciprocal switching agreements that Conrail had made available to NS and CSX, not agreements that CSX and NS had made available to Conrail. Second, the Board extended the reciprocal switching protections to shortline railroads that connect with Conrail.

More important to this discussion is the partial relief granted by the Board in response to various allegations raised by some parties in *Conrail Merger* with respect to reciprocal switching. Parties in Buffalo and Niagara Falls requested the reinstatement of reciprocal switching that had been canceled by Conrail prior to the filing of the notice of intent to merge had been filed. The Board denied relief to the shippers in the Buffalo area. The Board's reasoning for denying the reinstatement for the Buffalo shippers was that the record supported that the cancellations were part of a routine updating for shippers no longer present or no longer desiring rail service. Most notably, the Board denied the requested relief because no shipper had come forward to testify that it had been wrongly identified as missing or inactive.

The Board granted relief with respect to the switching cancellations in the Niagara Falls area that had occurred approximately one year prior to the filing of the notice of intent. In granting the relief, the Board stated that it would extend the NIT League agreement, which was intended to mitigate the market power that CSX and NS would inherit from Conrail, to cover the shippers "in the Niagara Falls area where Conrail [had] recently replaced its switching charges with equivalent 'line haul' charges." *Conrail Merger Decision* at 87. The Board clarified in a later decision that the relief granted to the Niagara Falls area shippers was intended to improve competition not to preserve competition. Therefore, the Board stated that there was no need for the Board to rule on the allegation that Conrail's cancellation of the switching was a transaction-related competitive harm. *See Conrail Merger*, Decision No. 124, Slip op. at 7 n.18 (STB served May 20, 1999).

While the Board expanded competition by restoring reciprocal switching to some shippers in *Conrail Merger*, the Board stopped short of re-instituting reciprocal switching for all shippers that had been subject to a cancellation of their reciprocal switching access prior to the transaction. Nevertheless, it is only a small step to protect all such shippers that request the restatement of their reciprocal switching rights in the context of a merger, when they had enjoyed reciprocal switching access within the 24-month period prior to the applicant carriers filing a notice of intent under 49 C.F.R. 1180.4(b). As will be shown further below, KCS' proposed rule on reinstating reciprocal switching within the context of a merger is well balanced and is in the public interest.

Proposed Modification To Existing Regulation

The modification to the existing merger rules proposed in this section would require applicants under 49 U.S.C. § 11323 *et seq.* to disclose all stations, facilities, or terminals that were closed to reciprocal switching by any of the applicants at any time during the 24 month period prior to the applicants filing their notice of intent pursuant to 49 C.F.R. § 1180.4(b). The proposed rule would create a rebuttable presumption so that upon the request of any party, any stations, facilities, or terminals that had been closed during the 24-month period would be reopened to reciprocal switching. Any applicant wanting to overcome the presumption would need to show that keeping the facility, station, or terminal closed was substantially in the public interest. The proposed new merger rule regarding reciprocal switching would amend Section 1180.6 of the Board's regulations by adding the following provision as Subsection (b)(9):

> (9) Applicants (including their subsidiaries, whether owned in part or in whole) shall be required to disclose to the Board and any other party all stations, facilities, or terminals served by any applicant that were open to reciprocal switching at any time during the 24-month period prior to the filing of a notice of intent pursuant to 49 C.F.R. § 1180.4(b). For each such station, facility, or terminal that had been open to reciprocal switching during the 24-month period but which is no longer open to such reciprocal switching at the time of the filing of a notice of intent pursuant to 49 C.F.R. § 1180.4(b), a rebuttable presumption will be created that favors the reinstatement of the reciprocal switching. Upon request of any party, the Board shall require applicants to reopen all such stations, facilities, or terminals to reciprocal switching as a condition for approval of any merger or control transaction. Applicants may overcome the rebuttable presumption only upon a showing that there is substantial public interest in keeping the facility, station, or terminal closed to reciprocal switching upon approval of the merger.

Impact Of The Proposed Modification

The impact of KCS' proposed modification on applicant carriers will be negligible while the benefit to the public will be substantial. The applicants in a transaction filed under Section 11323 will merely be required to disclose to the Board and the public the station, facility or terminal that had been closed to reciprocal switching during the 24 months immediately preceding the filing of the notice of intent. With this knowledge, any party that lost access rights via reciprocal switching during the reportable time period could request, and the Board could grant, the reinstatement of the access rights that were previously available to the requesting party. The relief available under this provision would not be subject to the competitive access standards found in 49 C.F.R. Part 1144 that would normally be required to be met for relief from the cancellation of a switching arrangement outside the context of a merger.

Notwithstanding, the impact on the applicant carriers would remain minimal because the proposal is simply restoring the reciprocal switching service that had previously been in place.

Justification For The Proposed Modification

The Board has "broad powers" to impose conditions on approval of an application filed under 49 U.S.C. § 11323. *See* 49 U.S.C. § 11324(c); 49 C.F.R. § 1180.1(d)(1) (1999); *Lamoille Valley R.R. Co. v. ICC*, 711 F.2d 295, 302 (D.C. Cir. 1983); *Southern Pac. Transp. Co. et al. v. ICC*, 736 F.2d 708 (D.C. Cir. 1984) ("*SP v. ICC*"). The Board's broad conditioning powers are intended to allow the Board to protect the public interest. *Grainbelt Corp. et al. v. STB*, 109 F.3d 794, 796 (D.C. Cir. 1997); *SP v. ICC*, 736 F.2d at 712 ("In deciding whether and what conditions to impose, the Commission's guide is the public interest."). The power to grant conditions, including the power specifically granted the Board to authorize access to facilities such as reciprocal switching, is contained in the same regulatory section that requires the Board to grant an application only if it serves the public interest (49 U.S.C. § 11324(c)). Accordingly, the Board's conditioning powers are intended to allow the Board to relieve the public harm that would result from the transaction without conditions, in this case without the restoration of the reciprocal switching that had been in place at a specified time prior to the transaction.

As noted above, the Board restored reciprocal switching to certain shippers and other carriers in *Conrail Merger* that had been canceled one year before the notice of intent was filed. *See Conrail Merger Decision* at 86. Some of these entities would have received restoration of the reciprocal switching under the NIT League settlement agreement without the expansion by the Board. However, some of the entities obtained restored reciprocal switching solely under the Board's conditioning power. As the Board affirmed, the restoration of the reciprocal switching in the CSX-NS-Conrail transaction would help "mitigate the market power" that the applicant carriers would have gained as a result of the merger. *Conrail Merger Decision* at 87. Thus the Board has already approved and justified the restoration of reciprocal switching in some circumstances to alleviate the market power gained by an applicant carrier in a merger.

The Board has acknowledged the importance of reciprocal switching access in most of the recent mergers. Culminating with the most recently approved merger, the Board has defined two to one facilities as a location that was served by two railroads either directly or *via reciprocal switch* and by no other railroad prior to the merger. *See CN/IC Merger Decision* at 84 n.172. The protection of a facility's access rights as a two to one shipper, even if those rights were by reciprocal switch rather than direct access, underscores the Board's commitment to reciprocal switching rights. The Board's commitment to protecting entities that have reciprocal switching at the time of the merger should be refined to include restoring reciprocal switching for all entities that had their access canceled within the 24-month time period before the applicants filed their notice of intent.

KCS' proposed regulation regarding reciprocal switching is the least intrusive method to protect competition in a continually consolidating rail industry. Reinstating reciprocal switching can be viewed as either enhancing competition or merely maintaining recently lost competition. However, the reinstatement of reciprocal switching where it previously had been in place cannot be said to create operational or safety problems that other forms of access might entail since the service recently had been provided and will continue to be provided by only one entity.

Furthermore, the entity seeking the restoration of reciprocal switching is not being placed in a significantly better position than they had been in prior to the merger.

KCS acknowledges that Board may ultimately determine in this rulemaking that enhancing competition is a more important objective than it had been in past mergers. Nevertheless, KCS believes that extreme and drastic measures aimed at tipping the balance dramatically in favor of creating new competition would be extremely harmful to the rail industry. Consequently, the restoration of reciprocal switching that had been in place at some point during the 24 months prior to the notice of intent to merge is a model revision to the merger rules because it appropriately enhances and preserves reciprocal switching access that had previously been in place immediately prior to the transaction.

Conclusion

In summary, KCS believes that the Board's merger regulations would be improved if they included the requirement that applicants disclose recently canceled reciprocal switching at any facility, station, or terminal. Creating a rebuttable presumption that would reinstate the canceled reciprocal switching upon request would further the public interest by enhancing and preserving competition. Furthermore, KCS believes that its proposed rule on reciprocal switching offers an appropriate balancing of interests that should be fundamental in this rulemaking process.

VI. THE DEFINITION OF "MAJOR" MERGER TRANSACTIONS SHOULD BE LIMITED TO MERGERS INVOLVING ONLY THE LARGEST RAILROADS

Introduction

The Board's current merger regulations categorize merger transactions based upon the annual revenues of the merging entities, applying a higher standard of review, and imposing more exacting informational requirements, on transactions involving larger carriers. However, even before the ICC began using the terms "major," "minor" and "significant" to describe various categories of rail mergers, merger and control applications (and the information they were required to contain) were segregated by the nature of the parties involved and the specifics of the proposed transaction. Over the past two decades, these standards have been modified a number of times to reflect the changing face of North American railroading, and to assure that the Board's merger review appropriately balances the competing directives of minimizing regulatory intrusion and protecting the public interest. KCS believes that it is time to modify the standards once again, to assist in preserving the competitive options provided by the nation's regional freight railroads. Specifically, KCS proposes that mergers involving two or more Class I carriers be treated as a "significant" and not a "major" transaction to the extent that one of the Class I carriers has net annual operating revenues of less than $1 billion in the previous calendar year, unless the merger is being effected against the corporate will of the smaller Class I carrier, in which case the merger would be treated as a "major" transaction. Such a modification to the existing classifications would more appropriately reflect the current disparity among Class I carriers, would better protect the public interest, and would further the Board's directive to minimize regulation of the rail industry.

With all candor, KCS states that it is currently the only Class I railroad which would be impacted by the proposed regulatory revision. However, several large Class II carriers, including Wisconsin Central Ltd. ("WCL"), Montana Rail Link ("MRL"), and Florida East Coast Railway Company ("FEC"), are all growing their operating revenues and may soon cross the revenue threshold into Class I status. KCS and all of these carriers share a common trait: while filling important roles in the markets they serve, they do not exhibit anything approaching the market reach of the six largest Class I railroads. Due to the limited geographic scope of regional carriers, a merger of one of them into one of the largest Class I railroads would not raise the competitive issues, nor require the same depth of review, as should properly be accorded to a merger of the two of the Class I giants. However, because these regional carriers have sufficient size to compete (on a limited basis, in select markets) with the mega-Class I carriers, it is critical that any attempt to control them against their will must be met with the highest level of scrutiny, to ensure that competition, safety, and service do not suffer.

The only method of satisfying the competing goals of reduced regulatory barriers for transactions not meriting the Board's more searching review, and the protection against unsolicited control of the vital role played by smaller carriers in the provision of competitive rail options, is to allow the smaller Class I carriers to elect whether their control transactions should proceed under a "major" or "significant" designation. KCS therefore proposes to modify the Board's merger regulations to allow such an election, in order to promote the public interest.

Existing Regulations:

49 C.F.R. § 1180.1 is captioned:

General Policy Statement For Merger Or Control Of Two Or More Class I Railroads.

49 C.F.R. § 1180.2 states in relevant part:

Types of transactions.

Transactions proposed under 49 U.S.C. § 11323 involving more than one common carrier by railroad are of four types: *Major*, *significant*, *minor*, and *exempt*.

(a) A *major* transaction is a control or merger involving two or more class I railroads.

(b) A *significant* transaction is a transaction not involving the control or merger or two or more class I railroads that is of regional or national transportation significance as that phrase is used in 49 U.S.C. § 11325(a)(2) and

(c) A transaction not involving the control or merger of two or more class I railroads is not significant if a determination can be made either:

(1) That the transaction clearly will not have any anticompetitive effects, or

(2) That any anticompetitive effects of the transaction will clearly be outweighed by the transaction's anticipated contribution to the public interest in meeting significant transportation needs.

A transaction not involving the control or merger of two or more class I railroads is significant if neither such determination can clearly be made.

(emphasis in original).

<u>Proposed Modifications To Existing Regulations</u>:

49 C.F.R. § 1180.1 would be captioned:

General Policy Statement For Major Transactions As Defined In 49 C.F.R. § 1180.2(a).

49 C.F.R. § 1180.2 would be revised to state:

Types of transactions.

Transactions proposed under 49 U.S.C. § 11323 involving more than one common carrier by railroad are of four types: *Major*, *significant*, *minor*, and *exempt*.

(a) A *major* transaction is a control or merger involving two or more class I railroads where at least one of the railroads involved in the transaction had gross U.S. railroad operating revenues of $1 billion in the last calendar year. However, in the event a control or merger transaction involves only two Class I railroads or two Class I railroads and one or more Class II railroads and one of the Class I railroads involved in the merger or control has gross U.S. railroad operating revenues of less than $1 billion in the last calendar year, the transaction shall be treated as a significant transaction, and is exempt from the application of 49 U.S.C. § 11324(b) (but is subject to 49 U.S.C. § 11324(d)) pursuant to the authority of 49 U.S.C. § 10502, unless such Class I railroad objects to the proposed merger or control, in which case the merger or control shall be treated as a major transaction.

(b) A *significant* transaction is a transaction that is not a major transaction but that is of regional or national transportation significance as that phrase is used in 49 U.S.C. § 11325(a)(2) and (c). A transaction which is not a major transaction is also not significant if a determination can be made either:

(1) That the transaction clearly will not have any anticompetitive effects, or

(2) That any anticompetitive effects of the transaction will clearly be outweighed by the transaction's anticipated contribution to the public interest in meeting significant transportation needs.

A transaction which is not a major transaction is also not significant if neither such determination can clearly be made.

History Of The Existing Regulations

The history of the division of merger transactions into categories based upon such criteria as the revenues of the involved railroads and the nature of the proposed transaction reflects that the definitions have often been modified, always to meet the evolving needs of the railroad industry. The regulatory recognition that different levels of scrutiny are appropriate for different transactions began several years prior to the enactment of the Staggers Act. In 1976, the ICC issued a Notice of Proposed Rulemaking and Order in which it proposed to modify the merger regulations to accord the greatest level of scrutiny to consolidations[22] if they involved at least one Class I railroad, or were trackage rights exceeding 100 miles, or were rail consolidations proposed by the Secretary of Transportation. *Railroad Consolidation Procedures*, Ex Parte No. 282 (Sub-No. 1) ("*1976 NPRO*"), 41 Fed. Reg. 21,481, 21482 (1976). However, the U.S. Department of Transportation ("DOT") proposed to narrow the scope of transactions requiring the Commission's heightened scrutiny. DOT's proposal recognized that the mere fact that a merger involved one Class I carrier did not warrant full regulatory review; rather, it was only the

[22]"Consolidations" includes mergers, acquisition of control, leases, acquisitions, coordination projects, and trackage rights.

merger of two of the nation's largest rail carriers that justified such scrutiny. Ultimately, DOT's proposal was adopted by the ICC, and the regulations were amended to mandate three classifications for merger applications, in declining order of significance and data requirements:

> I. Applications involving two or more Class I carriers;
> II. Applications involving two or more Class II carriers, or a Class I carrier and a Class II carrier; and
> III. Applications involving trackage rights, joint use, or joint ownership of a line or coordination project, except for those applications which result in a major market extension.

Railroad Consolidation Procedures, 348 I.C.C. 771, 781 (1977).

The ICC justified the separation of Class II carriers from the "most significant" category on two bases:

> First, the localized nature of Class II rail carriers generally reflects the fact that the information required to evaluate the effect of such transactions upon the existing interchanges and traffic flows need not be as extensive as in the case of the proposed consolidation of two Class I railroads. Secondly, a Class I railroad is not likely to be financially burdened by assuming the outstanding obligations of a railroad of Class II size.

Id. at 780.

Two years after these and other changes to the merger regulations were adopted, and after gaining valuable insight while processing several merger applications under the revised rules, the ICC again proposed to modify the merger regulations. As originally proposed in the 1979 Notice of Proposed Rulemaking, "major" transactions would have included two or more Class I or Class II railroads and involved either (1) control, merger or consolidation or (2) a major market extension. *Railroad Acquisition, Control, Merger, Consolidation, Coordination Project, Trackage Rights And Lease Procedures*, Ex Parte No. 282 (Sub-No. 2), 44 Fed. Reg. 66,626, 66,627 (1979). Seven categories of exempt transactions (largely paralleling those existing today) were proposed, and all other transactions were to be considered "minor" transactions. *Id.*

In adopting the final rules, however, the Commission modified this proposal slightly, excluding transactions involving only Class II carriers from the definition of a "major" transaction, meaning that a major transaction involved a Class I carrier and one or more Class I or Class II carriers. *Railroad Consolidation Procedures*, 363 I.C.C. 200, 202 (1980). Transactions involving only Class II carriers were moved to "minor" transaction status. *Id.*

In the Fall of 1980, Congress passed the Staggers Act, which made a host of changes to the rail merger statute and required the Commission to amend its merger regulations accordingly. One important change was the reduction in the maximum time frames during which the Commission may consider transactions not involving two or more Class I railroads. 49 U.S.C. § 11345(c) (now 49 U.S.C. § 11324(c)). On an interim basis, in order to accommodate the changes brought about by the Staggers Act, the Commission modified its regulations, redefining "major" transactions to involve either the merger of Class I carriers or transactions of regional or national transportation significance. All other transactions (except exempt transactions) were deemed "minor." *Rail Consolidation Procedures – Time Revisions*, Ex Parte No. 282 (Sub-No. 8), 45 Fed. Reg. 74,488 (1980). However, because of its experience administering regulations with a bi-partite "major" classification (essentially involving either the objective "Class I" or the subjective "regional or national transportation significance" standards), the Commission ultimately adopted a four-part classification for transactions: major (merger or control of two or more Class I railroads); significant (one Class I railroad, acting with another Class I or Class II railroad to bring about a major market extension); exempt (one of seven narrow categories) and minor (all rail transactions not described by the other classifications). *Railroad Consolidation Procedures*, 366 I.C.C. 75, 93 (1982).

For present purposes, the final substantive change made to the Rail Consolidation Procedures occurred in 1992, when the Commission redefined "significant" transactions. Because significant transactions were defined in part by the fact that they brought about "major market extensions," and because major market extensions in turn were defined as transactions which "may significantly increase competition," the rules in existence at that time perversely required more information, and set longer deadlines, for the more pro-competitive significant transactions than they did for minor transactions. To remedy this curiosity, the Commission adopted the current definition of significant transactions, which includes transactions that are of regional or rational significance but excludes major transactions and transactions which are either clearly not anticompetitive, or which will contribute more to the public interest than they will provide anticompetitive bi-products. *Railroad Consolidation Procedures: Definition of, and Requirements Applicable to, "Significant" Transactions*, Ex Parte No. 282 (Sub-No. 17) (ICC served July 21, 1992).

As this historical recitation demonstrates, the current standards for what constitutes a "major" or "significant" transaction have not remained static, but rather have been updated periodically . The changes made to these standards reflect the changing nature of the rail industry, and the need for the Board (and the Commission before it) to assure that the standards reflect an appropriate balance of Congress' dual mandate to protect the public interest and minimize regulatory burdens. KCS' proposed modifications reflect the belief that the regulatory burden can be further reduced on transactions proposing the merger of a large and a small Class I carrier, unless such control is to be effected against the desires of the smaller carrier. In such instances, the public interest dictates that the Board's full review powers be employed.

Impact Of The Proposed Modification

The changes proposed by KCS would modify the Board's traditional merger review on a number of significant but limited fronts, all leading to improvements in the Board's regulation of railroads. First, the period of time during which the consolidation of a smaller Class I and a larger Class I railroad is reviewed would be reduced in cases where the consolidation was treated as a significant transaction. Thus, the prefiling notification period (49 C.F.R. § 1180.4(b)(1)), the time for filing responses to applications (49 C.F.R. § 1180.4(d)(1)), responsive applications (49 C.F.R. § 1180.4(d)(4)(i)), and the evidentiary portion of the proceeding (49 C.F.R. § 1180.4(e)(2)) would all be reduced to reflect the significance of the transaction. In addition, the applicants would be faced with a reduced information burden, eliminating the need to submit 10-K (49 C.F.R. § 1180.6(b)(1)) and S-14 forms (49 C.F.R. § 1180.6(b)(2)), annual reports (49 C.F.R. § 1180.6(b)(4)), and certain other financial information (49 C.F.R. § 1180.9). The proposed changes would specifically exempt applicable transactions from the considerations listed in 49 U.S.C. § 11324(b), and instead the more appropriate standards of 49 U.S.C. § 11324(d) would be applicable. Finally, the general policy statement found at 49 C.F.R. § 1180.1 would be recaptioned so as only to apply to major transactions.

KCS' proposed changes to the Board's Rail Consolidation Procedures would have a very modest impact on the overall regulation of railroads. The changes would not adjust the existing standards or thresholds for the classification of railroads into Class I, II, and III categories as provided at 49 C.F.R. § 1201 and last modified in *Montana Rail Link, Inc. and Wisc. Cent. Ltd., Joint Petition for Rulemaking with Respect to 49 C.F.R. Part 1201*, 8 I.C.C.2d 625 (1992). Nor would the changes relieve KCS (or any other carrier than might soon be classified as a smaller Class I railroad) of the obligation to follow the Uniform Systems of Accounts contained at 49

C.F.R. § 1201. The changes also would not have any impact on the Board's consideration of the next round of "mega-mergers" among the largest Class I carriers, because such mergers would still be considered "major transactions." The Board's regulations regarding market analyses (49 C.F.R. § 1180.7) and operational data (49 C.F.R. § 1180.8) would continue to apply to all mergers involving only Class I railroads because both of those sections apply to both major and significant transactions. Finally, the changes would not impose any additional burdens on Class II carriers (or the Board) in securing authority to engage in "significant" transactions.

Justification For The Proposed Modification

1. The Consolidation Of A Larger Class I Railroad With A Smaller Class I Railroad Is Most Appropriately Considered A "Significant" Transaction

Pursuant to 49 C.F.R. § 1202.1-1, the Board groups rail carriers into one of three classifications, depending upon annual operating revenues, as follows:

Class I	Over $250 million
Class II	Between $20 million and $250 million
Class III	Less than $20 million[23]

Currently, seven railroads qualify as Class I carriers.[24] They are listed below, along with their operating revenue for 1999:[25]

Union Pacific Railroad	$	10.2 billion
The Burlington Northern and Santa Fe Railway	$	9.1 billion
CSX Transportation, Inc.	$	5.6 billion
Norfolk Southern Corporation	$	5.2 billion
Canadian National Railway (including Illinois Central)	$	3.5 billion

[23] The actual operating revenues used for purposes of classifying railroads are adjusted yearly to take account for inflation. Also, railroads are not reclassified unless they earn three consecutive years of operating revenue above or below their current classification. 49 C.F.R. § 1201.1-1(b)(1).

[24] The data below reflects railway operating revenue and track miles based upon consolidated figures for parent and wholly-owned rail subsidiaries.

[25] In U.S. dollars. Canadian dollars were converted using the May 1, 2000 exchange rate of 1.4783 Canadian dollars per U.S. dollar.

Canadian Pacific Railway	$ 2.4 billion
The Kansas City Southern Railway Company	$ 519.2 million

The disparity between the largest and smallest Class I carriers can also be measured by total track miles:

Union Pacific Railroad	33,705
The Burlington Northern and Santa Fe Railway	33,500
CSX Transportation, Inc.	23,400
Norfolk Southern Corporation	21,800
Canadian National Railway (including Illinois Central)	15,777
Canadian Pacific Railway	14,358
The Kansas City Southern Railway Company	3,718

As can easily be seen from the above listings, and as is readily apparent to anyone familiar with North American railroading, the "Big Seven" is really the "Big Six Plus One." The six largest Class I railroads have much more in common with one another than they do with KCS. Each of the largest Class I carriers boasts annual operating revenues exceeding $2.4 billion dollars. By contrast, KCS' $519 million in annual operating revenue is less than one-quarter of the smallest of the "Big Six," and its 3,700 track miles is slightly larger than one-quarter of the next Class I carrier's mileage. This enormous disparity, which has developed over the last decade primarily as a result of the numerous large mergers which have taken place, is indicative of the differences between KCS and the other Class I railroads. Obviously, the gap would be even larger between the largest Class I carriers and regional carriers like WCL, FEC and MRL, which might soon qualify as Class I carriers.

Given the emphasis that the Board traditionally has placed on competitive issues in reviewing merger applications, it is also important to note the great difference in market reach and geographic scope of the "Big Six" versus the smaller Class I carriers. All of the major Class I railroads reach from one coast (at least) to Chicago, the nation's rail hub. Numerous secondary main lines and branch lines enhance the ability of these large carriers to participate as the primary trunk carrier for the bulk of the freight it moves. Indeed, given the large number of major markets these carriers serve, they function as both originating and terminating carrier on a significant percentage of their traffic. This great breadth of market power allows the largest Class I carriers to actively impact the transportation decisions of most large shippers.

By contrast, KCS and the largest Class II carriers that might soon qualify as Class I's, such as WCL, MRL, and FEC, serve much more limited geographic areas. While clearly providing important competitive options within the markets they reach, the simple fact is that they do not reach enough markets to wield the tremendous influence on competition exercised by the larger Class I's. A greater percentage of their traffic is interchanged with other carriers (usually the "Big Six"), and in fact a good deal of their traffic is bridge traffic, with neither an origin nor a destination on-line. At a bare minimum, the inherent differences in the markets in which smaller Class I railroads operate indicates that the Board should give thoughtful consideration to the appropriateness of applying rules designed for much larger mergers to these smaller carriers.[26]

Given the divergent nature of the largest and smallest Class I railroads, it is entirely appropriate for the Board to determine that a merger involving a large and a small Class I railroad does not present the same issues as were confronted in the mega-mergers of equals which the Board and its predecessor have been called upon to authorize in the last decade. The scope of competitive issues is almost assuredly reduced, and the number of active participants in the proceeding should also be greatly reduced. Therefore, the overall time needed to consider the merits of the application can be shortened. Similarly, given the relatively limited impact which

[26] It is instructive to note that the Board's regulations exempt switching and terminal companies from consideration as anything but Class III railroads, regardless of their operating revenues. 49 C.F.R. § 1201.1-1(d). Thus, class designation is not solely dependent upon operating revenues, but must also take into account the nature of the railroad's operations.

acquisition of a smaller Class I carrier would have on the balance sheets of the Class I titans, the requirement for extensive financial information is eliminated. Finally, the need for the Board to consider the public interest considerations itemized in 49 U.S.C. § 11324(b) is assuaged by the finite market reach of the smaller carrier to be acquired.

The Board's recent experience demonstrates that it can safely reduce the merger of a large Class I and a small Class I railroad to "significant" transaction status without concern that important issues might be missed. In *CN/IC Merger*, the Board was presented with the merger of CN, a transcontinental Canadian carrier with access to the Atlantic and Pacific oceans, most major Canadian markets, and several key U.S. markets, and IC, a smaller Class I carrier connecting Chicago with New Orleans. *CN/IC Merger* proceeded on a shorter time frame and provoked less opposition than any other "major" transaction in recent memory. Although *CN/IC Merger* was processed under the "major" transaction analysis, the small number of legitimate issues presented in that merger simply did not justify satisfaction of many of the involved regulations. *CN/IC Merger* is indicative of the reduced level of review that is appropriate for mergers involving only one of the largest Class I carriers.

2. The Economic Disparity Between Large and Small Class I Railroads Justifies Protecting The Public Interest By Allowing The Smaller Class I Carrier To Determine Whether A Merger Is "Major" Or "Significant"

As detailed above, the merger of one large and one small Class I carrier can, under most circumstances, be accomplished as a "significant" transaction without concern for financial, competitive, or timing issues. However, KCS does not believe that this is always the case. Given the remarkable contrast between the financial capabilities of larger and smaller Class I carriers, it is distinctly possible that a smaller Class I carrier could be pulled into a control transaction against its will. In light of the serious operational problems that have resulted from many recent "friendly" mergers, the possibility exists that even more problematic situations could be presented by a "hostile" merger. The serious competitive concerns that would be raised by a hostile takeover attempt would warrant a full review of the consolidation under the "major" transaction regulations.

The divergent financial strength of the "Big Six" Class I railroads from the smaller Class I (and soon-to-be Class I) railroads carries over into their ability to compel a merger transaction. Even with the seriously reduced stock prices at which many of the major rail carriers have recently been trading, it is difficult to imagine that any large Class I carrier could successfully effect a hostile merger with any other large Class I carrier. Each of the large carriers has the financial ability to ward off any unwelcome overtures. The same cannot be said of the KCS and the larger Class II railroads. For publicly traded railroads such as KCS, the ability to mount a credible defense to a hostile takeover is diminished by the limited available resources. Even for privately held railroads, the financial squeeze which they could suffer at the hands of their significant Class I connection (such as BNSF for MRL, or CN for WCL, by way of example) means that to some extent, they could be squeezed into capitulation with unwanted suitors.

Again, recent history bears witness to this scenario. When CSX announced its intention to merge with Conrail (a "friendly" merger), Norfolk Southern began an all-out, "hostile" blitz to instead be selected as Conrail's merger partner. A large-scale securities battle ensued, which ended only when the parties agreed to divide the Conrail franchise. For present purposes, the important reminder from this incident is that Conrail had the financial wherewithal to successfully defend itself against a hostile takeover attempt. Unfortunately, neither KCS nor any of the larger Class II railroads which might soon qualify as Class I carriers have anything close to Conrail's finances. There is simply no way that they could prevent one of the larger Class I railroads from securing a controlling position in their publicly traded stock. Nor, for privately held railroads, do they have such a broad customer base or market reach that would allow them to withstand prolonged adverse treatment from their primary Class I connection.

The public interest would suffer irreparable harm if a larger Class I railroad were to succeed in forcing control on a smaller Class I carrier. Modern rail mergers have been marred by serious service disruptions resulting from an inability to smoothly meld two different operating systems, computer systems, financial systems, etc. These well-documented problems have been endured despite the best efforts of all sides to bring about a harmonious union. Now, if one of the parties to a merger were to refrain from cooperating with its would-be merger partner, the problems of bringing the two entities together would be geometrically increased. It is not difficult to imagine, for example, that a failure to adequately coordinate the integrated operations of the merged carriers could result in horrendous congestion, slowed velocity, and service disruptions for many shippers. Additional problems could arise if the management for the unwilling merger partner did not support the consolidation.

These concerns are most appropriately addressed by allowing the smaller Class I railroad to elect whether a merger proceeding involving it should proceed under the "major" or "significant" designation. Under normal circumstances, the "significant" designation would be followed, which would properly reflect the limited impact of such a transaction. However, should the smaller Class I railroad be pulled into a merger (either because of Class I leverage or because the smaller carrier was unable to successfully fend off an unwanted stock accumulation), it would be most appropriate for such a merger to be reviewed under the full "major" classification. Only through use of the full merger review could the Board be assured that the public interest will be protected.

3. Use Of An Exemption Under 49 U.S.C. § 10502 Is Appropriate From 49 U.S.C. § 11324(b), Which Contains The Statutory Factors To Be Considered For Mergers Of "Two Class I Railroads"

As the Board is aware, 49 U.S.C. § 11324(b) requires that the Board consider five separate factors when determining whether a proposed combination of Class I railroads should be authorized:

(1) the effect of the proposed transaction on the adequacy of transportation to the public;
(2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction;
(3) the total fixed charges that result from the proposed transaction;
(4) the interest of rail carrier employees affected by the proposed transaction; and
(5) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system.

Taken together, these five factors express appropriate concerns for the remaining "major" rail consolidations, during which the largest Class I carriers are expected to reduce in number from six to three or two. However, it is not necessary that these same concerns govern the merger of a large and a small Class I railroad. Such mergers will be similar in effect and economic impact to the merger of a large Class I railroad and a Class II railroad, which, it has been found, could be appropriately reviewed under the "significant" merger procedures and the considerations contained at 49 U.S.C. § 11324(d).

Therefore, an exemption from the requirements of Section 11324(b) is justified for large Class I-small Class I mergers, if they are to be treated as "significant" transactions under KCS' proposal. Indeed, it would be inconsistent to reduce the information required of a merger application between a large and small Class I carrier down to "significant" status for purposes of 49 C.F.R. § 1180 but then to attempt to consider the merits of the proposed combination under the full "major" factors of Section 11324(b). In other words, proper consideration of the five factors listed in Section 11324(b) could not be given to a merger application which was filed in compliance with the reduced requirements of a "significant" transaction under 49 C.F.R. Part 1180. An exemption from Section 11324(b) should therefore be granted in conjunction with the reclassification of "large Class I-small Class I" mergers to "significant" transaction status.[27]

The exemption authority of Section 10502 may be exercised when any provision of the statute relating to the regulation of railroads:

> (1) is not necessary to carry out the transportation policy of [49 U.S.C. § 10101]; and
> (2) either –
> (A) the transaction or service is of limited scope; or
> (B) the application in whole or in part of the provision is not needed to protect shippers from the abuse of market power.

49 U.S.C. § 10502(a).

This case squarely fits these criteria. Exempting mergers of a small and a large Class I railroad from the requirements of Section 11324(b) (while continuing to review them under the standards of 49 U.S.C. § 11324(d)) would "minimize the need for Federal regulatory control over the rail transportation system" (49 U.S.C. § 10101(2)); would "foster sound economic conditions in transportation" and "ensure effective competition and coordination between rail carriers and other modes" (49 U.S.C. § 10101(5)); and would "provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part" (49 U.S.C. § 10101(15)).

Moreover, the proposed exemption would be "of limited scope." 49 U.S.C. § 10502(a)(2)(A). It would only apply to transactions involving small and large Class I carriers. Further, it would not eliminate the regulatory review of such transactions, but would only subject

[27] However, should the smaller Class I carrier elect to have the transaction treated as a "major" transaction, the heightened standards of Section 11324(b) would apply.

them to less-rigorous scrutiny. The Board would retain its ability to protect the public interest through a complete examination of all relevant data, and all interested parties would retain their ability to comment on the transaction and otherwise participate fully in the proceeding. Given the relatively small number of transactions which would be impacted by this exemption, and the modest reduction in the scope of the Board's review of such transactions, it can safely be said that the requested exemption is of limited scope.

Finally, consideration of the five factors enumerated in Section 11324(b) is "not needed to protect shippers from the abuse of market power." The merger of smaller Class I railroads into larger Class I railroads would still be reviewed to determine whether "there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region in the United States." 49 U.S.C. § 11324(d)(1). The Board would also have sufficient information to determine whether "the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs." 49 U.S.C. § 11324(d)(2). Moreover, the Commission has previously found:

> The thrust of recent transportation legislation has tended toward less rather than more regulation, except where regulation is necessary to protect against the abuse of market power. No party has even attempted to show that mid-size carriers such as [WCL] and MRL will inappropriately exercise market power unless the statutory provisions applicable to class I carriers are applied to them as well.

Montana Rail Link, Inc. and Wis. Cent. Ltd., Joint Petition For Rulemaking With Respect To 49 C.F.R. Part 1201, 8 I.C.C.2d 625, 636 (1992).

<u>Conclusion</u>

In summary, KCS urges the Board to modify its existing merger regulations and grant a limited exemption to allow the merger of a larger Class I railroad with a smaller Class I railroad to be reviewed under the "significant" transaction standards, unless the smaller Class I carrier believes, because of the hostile nature of the consolidation, that the higher "major" transaction standards should be used. The proposed modifications, which would be limited in scope, would more appropriately recognize the differences between large and small Class I carriers, and would enable the Board to reduce the regulatory burdens involved in mergers while still protecting the public interest.

VII. MERGER APPLICANTS SHOULD BE REQUIRED TO DISCLOSE AND DISCUSS PAPER AND STEEL BARRIERS APPLICABLE TO THEIR SHORTLINE INTERCHANGE CONNECTIONS

Introduction

Shortline railroads are vital to the continued operation of the nation's light density rail lines. The service these smaller railroads provide, particularly to small communities, is crucial to the economy of many rural areas. Yet, these railroads' ability to provide cost-effective service is being endangered by continued Class I consolidation, by limits placed on their access to additional sources of revenue, and by increased demands for new infrastructure investment to handle larger cars and trains. A recurrent theme of the Board's Ex Parte 582 hearings was the competition-strangling effect that major mergers were having on smaller railroads and the lost revenues they were suffering, especially in the face of skyrocketing needs to make infrastructure investments. *See Public Views*, Testimony of Kevin V. Schieffer, President and Chief Executive Officer, Dakota, Minnesota & Eastern Railroad Corp. (*"Schieffer Testimony"*), and Written Statement Of A.V. (Tony) Reck, President, Chief Executive Officer, Paducah And Louisville Railway (*"Reck Testimony"*). Many of these effects are caused or made worse by paper and steel barriers imposed by larger railroads in light density line spinoffs, and thus are beyond the immediate scope of this proceeding. However, to the extent these effects are exacerbated by rail mergers, the Board should examine ways to alleviate merger-related effects and, if necessary, believes, because of the hostile nature of the consolidation, that the higher "major" transaction standards should be used. The proposed modifications, which would be limited in scope, would more appropriately recognize the differences between large and small Class I carriers, and would enable the Board to reduce the regulatory burdens involved in mergers while still protecting the public interest.

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Existing Policy

The Board's existing policy with respect to the removal of paper barriers thus far has been to allow the Rail Industry Agreement ("RIA")[28] to function. In line with that preference, the Board deferred action on a Western Coal Traffic League petition to institute further proceedings to establish regulations governing the elimination of paper barriers. *See Review of Rail Access and Competition Issues*, Ex Parte No. 575, Slip op. (STB served March 2, 1999) ("*Ex Parte 575*"). To date, the Board has remained reticent about further steps to deal with the paper and steel barriers issue. One effect of KCS' proposed rule would be to require merging carriers to provide sufficient information on these barriers for the Board to better assess the need for further steps on this issue.

Proposed Modification To The Existing Regulation

This proposal would create a new section to the Board's merger regulations at 49 C.F.R. § 1180.6(b)(10)[29] ("Subsection 1180.6(b)(10)") under the general heading "Supporting information," which would read as follows:

[28] *See generally Association of Am. Railroads and Am. Short Line and Reg'l R.R. Assoc. — Agreement — Application Under 49 U.S.C. 10706*, Docket No. S5R 100, Slip op. (STB served Dec. 11, 1998).

[29] The numbering of this proposed new subsection assumes the adoption of KCS' simultaneously-proposed new rule (b)(9), requiring major merger applicants to disclose and justify the barriers to competition that they have imposed upon connecting shortline and regional carriers in the form of steel and paper barriers.

In a *major* transaction, submit the following information:

* * *

(10) a list of all provisions of any agreement between any applicant and any Class II or Class III carrier (including a Class II or III carrier owned wholly or in part by an applicant) having a direct physical connection to one of the applicants which agreement in any way limits the ability of such Class II or Class III carrier to interchange or connect with any non-applicant carrier. For each such listed provision, applicants shall discuss the underlying rationale for such a provision and explain how the transaction will impact the operation of the provision. Applicants shall further discuss whether the provision should be removed, and analyze how removal of the provision would impact the proposed transaction. Upon request of any party, the Board will review such provisions and determine whether the public interest requires modifying or eliminating that provision to facilitate the ability of such a Class II or Class III carrier to interchange with, connect with, or otherwise conduct business with any other carrier.

Impact Of The Proposed Modification

The proposed rule is largely procedural, and does not mandate any substantive change in the Board's position announced in March 1999 in *Ex Parte No. 575*. Disclosure and discussion is the immediate goal. Requiring applicants in major consolidation transactions to present and justify paper and steel barriers to competition will give the Board a more complete overview of the barriers issue and allow assessment of the issue in light of a changing competitive landscape. Because mergers themselves limit competing routes available to shortlines, and thus limit their options for negotiating suitable divisions, reviewing competition-limiting paper and steel barriers in the same context would be both appropriate and useful. Only in the event that the combined effects of the paper or steel barriers and the merger are inconsistent with the public interest would the Board order removal or modification of those barriers.

Justification For The Proposed Modification

Since passage of the Staggers Act in 1980, shortline railroads have become a lifeline for shippers in smaller communities. They serve as an increasingly important source of intramodal

rail competition. Yet, many smaller railroads are struggling with capital needs that they cannot meet. Their efforts to meet these needs are hampered by increasing consolidation among Class I carriers and by so-called paper and steel barriers. By reducing shortlines' routing alternatives, both Class I consolidations and paper and steel barriers limit the small carrier's ability to obtain suitable revenue divisions. The proposed rule would require the disclosure of these barriers, and any other provisions of agreements between major merger applicants and Class II or III carriers that limit the smaller carrier's ability to interchange freely. This disclosure will enable the Board to determine whether these paper and steel barriers are consistent with the public interest in light of merger-caused changes in competitive circumstances.

Class II and III carriers have become an increasingly critical part of the intramodal rail competitive picture. The Mega-Class I mergers cause reductions in the number of available alternative routings. This, in turn, limits the ability of a Class II or III carrier to bargain among its connecting carriers for equitable divisions and increases the leverage of the newly merged Class I. For example, ten years ago there may have been four routes available for the small carrier to route between its line and a given off-line location. That availability allowed the smaller carrier to negotiate with several carriers for the best revenue division. Major mergers have reduced these options. As Paducah & Louisville Railway stated in its Ex Parte 582 testimony:

> As we have experienced in the past, the loss of an interchange partner at either end of our system not only causes an increase in rates to the shippers we serve, but generally pushes our divisions lower. Thus, the short line's portion of the overall revenue gets lower and lower, which in turn reduces our ability to improve our capital facilities, invest in additional cars and locomotives, and provide service to our customers.

Reck Testimony at 4-5. Similarly, Kevin Schieffer of Dakota, Minnesota & Eastern wrote, "[T]he mega-mergers eliminate prospective competitive connections for many regional and short-line railroads. This is a very significant issue for smaller lines." *Schieffer Testimony* at 3.

The other principal reason for the growing competitive importance of smaller railroads is the growth of smaller railroads themselves. As the number of Class I carriers has declined, the number of smaller carriers has skyrocketed. There are now approximately 500 Class II and III carriers in the United States. Together these carriers own between 49,000 and 50,000 U.S. route miles, nearly half the route mileage owned by the Class I's.[30]

Growth in shortline and regional railroads is due largely to purchases of light density lines from Class I carriers. While in 1980 Class I railroads operated nearly 165,000 road miles, by 1998 they operated just over 100,000 miles.[31] Many of the 65,000 miles of track eliminated from Class I systems have been purchased by smaller railroads.[32] Sometimes these transfers have occurred through offers of financial assistance (49 C.F.R. § 1152.27) or feeder railroad development procedures (49 U.S.C. § 10907 and 49 C.F.R. § 1151), but frequently they were the result of sales agreements negotiated between the Class I and the new shortline or regional carrier.

Often Class I line sales to regional and shortline carriers come with strings attached in the form of paper or steel barriers. Paper barriers are provisions in line sale agreements that restrict the shortline purchaser's ability to interchange freight with carriers other than the Class I seller of

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[30] *See Railroad Facts*, 1999 Edition, published by The AAR ("*RR Facts*") at 3.

[31] *RR Facts* at 44.

[32] *See A Report on the Ten-Year Needs of Short Line and Regional Railroads*, prepared by Standing Committee on Rail Transportation of the American Association of State Highway and Transportation Officials (1999) ("*AASHTO Study*") (stating that 37,000 miles of track abandoned by Class I's since 1970 has been acquired by Class II and III carriers).

the line.[33] These restrictions may be simple prohibitions on alternative interchange, requirements to tender high proportions of the shortline's traffic to the seller, or any of a variety of other types of incentives or requirements. Whatever their form, these paper barriers effectively prevent the shortline from interchanging with carriers other than the seller. "These 'paper barriers' by definition were anti-competitive, and had to be drawn very carefully so as to not blatantly run afoul of legal prohibitions regarding anti-competitive practices." *Schieffer Testimony* at 3.

Steel barriers - where the Class I seller retains a section of track principally to prevent direct physical interchange by the new shortline owner with another carrier - are another means by which Class I carriers essentially convert connecting shortline spinoffs into captive shippers. *Id.* Often when major carriers sell lines, they retain a relatively short segment of the track at the end of the line nearest a terminal or connection to another carrier. While various justifications for this may be offered - *e.g.*, need for an interchange track, possible later use as a spur or siding, etc., - the real reason is often to limit the shortline's access to other carriers. This happens time and time again, as those familiar with shortline operations will attest. Thus, as with a paper barrier, a steel barrier prevents the shortline from reaching a connection that competes with the Class I seller.

The loss of competition between interchange partners affects the shortline much as the two to one situation affects a shipper. Indeed, small railroads in many ways are affected by

[33] *See RailAmerica, Inc.— Control Exemption — RailTex, Inc.*, F.D. 33813, Slip Op. at 5 n.11 (STB served Jan 10, 2000). ("Paper barriers are clauses in contracts for the sale or lease of rail lines to shortline carriers by which Class I carriers selling or leasing track segments to smaller railroads seek to ensure that the traffic originated or terminated by shortline carriers on the segments (sold or leased) continues to flow over the lines of the seller to the maximum extent possible.")

major rail mergers much the same way as shippers.[34] Many shippers, for example, must use rail service for a portion of their shipping. Similarly, smaller railroads ordinarily must interchange with connecting Class I carriers because only a small proportion of shipments handled by smaller railroads both originate and terminate on their own lines. Therefore, the smaller carrier is often as dependent on its Class I connection as is a shipper who ships rail-dependent traffic. Similarly, while shippers seek rail competition to obtain lower prices, shortlines need competition among Class I connections to obtain equitable divisions. Like a shipper, a small railroad often is at the mercy of its Class I connection to remain in business.

Loss of Class I alternative routing choices and other effects of mergers adversely impact the revenues of Class II or III railroads. *See Reck Testimony* at 4-5 (quoted above).[35] A shortline seeking to move its shipper's traffic is just like any other railroad - it searches among the routes that will satisfy the shipper's needs for the routing that brings the shortline the best revenue division. The merger of Class I carriers normally eliminates at least one routing option available to the shortline. That means one less alternative for the shortline to obtain a suitable revenue division. This continued squeeze on shortline divisions can threaten the smaller railroad's very existence. *Id.* To recapture that revenue, the shortline might attempt to raise its rates. However, since many shortline shippers also have facilities off the shortline, the shipper often can shift its business activities to another location if the shortline attempts to recoup revenue lost through a

[34] *See generally Expedited Relief for Service Inadequacies*, Ex Parte No. 628, Slip Op. (STB served Dec. 21, 1998) (treating short line carriers much like shippers for purposes of emergency service relief).

[35] Current changes in Class I pricing practices to emphasize tariff rates over long term contracts may indicate that Class I carriers are becoming less afraid of losing traffic to competitors and more concerned with optimizing rates on traffic they handle. *See generally Pricing Changes*, Traffic World, Feb. 7, 2000, p. 10 (article discussing CSX's growing preference for the flexibility of tariff-based pricing over the mutual, long-term traffic and pricing commitments of service contracts). A similar effect may well be being felt by smaller carriers.

divisions squeeze, or often times, the shipper has made more bargaining leverage than the shortline and it is impossible to raise rates. Service problems resulting from major mergers also adversely affect the shortline which, like most captive shippers, cannot avoid, pass on, or recover the added costs caused by service problems on the merged carriers.

The effect of revenue limitations on smaller railroads is well-documented. A principal need of the smaller carrier is to generate sufficient capital to maintain and improve track. Collectively, Class II and III carriers generate about $3.0 billion from handling about 11 million carloads per year.[36] By contrast, Class I railroads' statistics show approximately 26 million cars handled annually, generating $33 billion in revenue.[37] More importantly, lines purchased by smaller railroads frequently suffer from maintenance deferrals by their former Class I owners.[38] Reviewing these and other pertinent facts, the *AASHTO Study* projected a shortfall of between $6.11 and $9.5 billion over the next 10 years in shortlines' ability to meet their capital needs.

This projected massive shortfall in shortlines' ability to meet their capital needs runs dangerously counter to the increasing importance of shortlines in maintaining intramodal rail competition. The shortline and regional railroad industry as a whole clearly will not be able to fulfill its role of offsetting the drop in competition among Class I's if the industry cannot generate the revenues needed to maintain its lines.[39]

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[36] *RR Facts* at 3.

[37] *Id.* at 9.

[38] *AASHTO Study* at. 1.

[39] This situation, indeed, bears many similarities to the situation of major railroads at the time of the Staggers Act. Congress' response in that situation was to lift restraints on competition to promote major railroads' financial health. Removing paper and steel barriers could have similar effects for smaller railroads.

This dangerous juxtaposition of trends - the increasing importance of smaller railroads to preserving service and competition for shippers while, at the same time, those railroads are suffering growing capital deficits - necessitates that the Board purposefully examine future major mergers for their effect on shortline and regional railroads. While KCS' proposed new Subsection 1180.6(b)(10) does not require the Board to eliminate paper or steel barriers, it does require that applicants in major transactions give the Board information necessary to analyze whether such barriers are in the public interest. The Board's Ex Parte 582 hearings and decision have made clear that the Board must apply new analytical processes to keep up with the imminent sea of change in the Class I competitive structure. Taking a serious look at the effect of paper and steel barriers on Class II and III efficiency and access in each major transaction proposed is one such new process which the Board should employ. Proposed new Subsection 1180.6(b)(10) gives the Board a tool necessary to that examination.

The rule proposed here would enable the Board to make such an examination while remaining consistent with Board precedent. In the past, the Board has shown a preference for allowing paper barrier issues to be handled under the RIA. At the same time, however, the Board's order in this proceeding recognizes the need to examine this issue. *ANPR* at 8.

The proposed rule would facilitate this examination while avoiding wholesale disallowance of agreed-upon commercial arrangements. First, by requiring disclosure in the merger context, the rule would cause large numbers of paper and steel barriers to be revealed, bringing the scope and prevalence of these barriers to light. This would enable the Board to obtain a better overview of the impact of these barriers on competition. Second, the rule would allow these barriers to be brought forward in context, rather than in isolation. For example, the relationship between and overall impact of various restrictions would be more evident in the context of a merger than if raised on a piecemeal basis.

Conclusion

Like KCS's proposal for disclosure of settlement agreements, this proposal is procedural only. It does not require the Board to take any action with respect to disclosed paper and steel barriers. Rather, it merely requires the merger applicants to inform the Board and the public of the scope of these conditions. In light of the increasingly important role of smaller carriers in preserving intramodal rail competition, the Board should take this moderate step in fulfilling its responsibilities to protect the public interest.

VIII. SUMMARY OF COMMENTS

In conclusion, KCS believes that each of the seven proposed modifications to the Board's existing merger regulations and policies is a balanced approach to ensuring that railroads provide shippers with responsive, dependable, and competitive service. The regulatory modifications suggested by KCS would allow rail carriers to continue to achieve the growth and efficiencies they desire, but would place squarely upon them a responsibility to avoid reducing competition in the process. Thus, KCS' proposed rules strike a delicate balance between those who seek to reregulate the rail industry through forced competitive access and those who are trying to protect the status quo.

None of the seven proposed changes guarantees to KCS, or to any other carrier, any traffic. They do not compel the Board to reopen any of its prior merger decisions, and they do not ask the Board to adopt an abrupt reversal of any long-established policies. Nor do they return railroads to the oppressive regulatory framework that existed before the Staggers Act. Indeed, KCS believes that these seven changes are a modest but critical step towards avoiding reregulation of railroads.

What the changes would bring about, in each instance, is a more competitive industry, guided by regulations which are in tune with the practical (and not merely the theoretical) realities of how modern railroading operates. Most importantly, the Board should recognize that harm to competition is likely to arise from three to two reductions in competition, particularly when the two merging entities are the dominant competitors in the market, or in some definable subsection of the market. The public interest demands that appropriate relief be fashioned where the level of competition is reduced by a rail merger. The Board should also consider whether restrictions imposed on conditions adopted in prior mergers remain in the public interest. Additionally, in future major merger proposals, applicants should be required to protect the benefits they touted as arising from their prior mergers. To the extent merging parties enter settlement agreements related to their merger, the Board must provide time for the disclosure and examination of the impacts of those agreements on the public benefits of the merger. Further, where parties have canceled reciprocal switching agreements prior to announcing an intent to merge, they should be required to disclose and justify those cancellations. The Board's definition of "major" merger transactions should be modified to better comport with the current diversity among Class I railroads. Finally, the Board should use its review of major rail mergers to examine the justifications for paper and steel barriers, which generally serve only to impede the ability of smaller carriers to provide competitive service and earn an adequate return on investment.

CERTIFICATE OF SERVICE

This is to certify that on this 16th day of May, 2000, I caused the foregoing "Comments of the Kansas City Southern Railway Company" in the Ex Parte No. 582 (Sub-No. 1) proceeding to be served upon counsel for all known parties of record by first class mail, postage prepaid, or by more expeditious means.

Tom Healey

Thomas J. Healey

KCS appreciates the opportunity to review these matters with the Board. KCS also looks forward to working with the Board and other parties towards improving the Board's regulation of what is likely to be the final round of major railroad mergers.

Respectfully submitted,

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Tom Healey

Thomas J. Healey

VERIFIED STATEMENT

OF

CURTIS M. GRIMM

I. Introduction

My name is Curtis M. Grimm, and I am Professor and Chair of Logistics, Business and Public Policy, College of Business and Management, University of Maryland at College Park. I have been a member of this College since 1983. I received my B.A. in economics from the University of Wisconsin-Madison in 1975 and my Ph.D. in economics from the University of California-Berkeley in 1983. My Ph.D. dissertation investigated competitive impacts of railroad mergers.

In my background, I have extensively addressed public policy issues regarding transportation, including those examined in Interstate Commerce Commission ("ICC") and Surface Transportation Board ("STB") merger and control proceedings. I have previously participated in several ICC and STB proceedings.[1] Specifically, I have provided testimony evaluating the competitive consequences of these and other transactions. My research has involved deregulation, competition policy, competitive interaction and management strategy, with a strong focus on transportation. This research has resulted in over 60 publications. More than two dozen publications have dealt specifically with the railroad industry, mainly on deregulation, mergers, and competition issues. I have also co-authored three monographs. Further details may be found in the attached vitae.

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[1] Wisconsin Cent. Transp. Corp. et al. -- Continuance in Control -- Fox Valley & W. Ltd., Finance Docket No. 32036; Union Pac. Corp. et al. -- Control and Merger -- Southern Pac. Rail Corp. et al., Finance Docket No. 32760 ("*UP/SP Merger*"); Kansas City S. Indus. et al. -- Control -- Gateway W. Rwy. Co. and Gateway E. Rwy. Co., Finance Docket No. 33311.

For many years I have advocated in my writings the importance of preserving and promoting railroad competition. I have long been convinced that preserving and extending the benefits of deregulation crucially hinges on the adequacy of railroad competition. In my previous submissions to the ICC and STB, I have consistently expressed my views as to the importance of preserving intramodal rail competition in the post-Staggers[2] rail industry. The remainder of the statement will detail my position in this regard as it relates to the current proceeding.

The Kansas City Southern Railway Company ("KCS") has requested my views on the rail merger rules which KCS is proposing in this proceeding, with a particular focus on preservation of competitive options. I support the KCS' proposed rules. The STB should elevate the importance of competition in evaluating railroad mergers and should establish a policy whereby shippers experience no reduction in competitive options. In particular, there should be no reduction in the number of independent rail carriers in origin/destination corridors. In practice, given the limited number of rail carriers remaining, the main issue for consideration vis-à-vis current merger policy is whether three to two effects need receive greater attention.

II. The Profound Value Of Strong Competition In The Railroad Industry In Promoting Efficiency And Public Benefits

An important backdrop to the discussion of the role of competition in merger proceedings is an assumption about the critical role of competition in the proper functioning of a free-market system. As noted by Scherer: "Competition has long been viewed as a force that leads to an optimal solution of the economic performance problem, just as monopoly has been condemned

[2] Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895 (1980) ("Staggers").

throughout recorded history for frustrating attainment of the competitive ideal." [3]

However, it is useful to note the multiple adverse effects of monopoly. Allocative inefficiency is one of these, but not the only one, nor even necessarily the most important one. Insulation from competitive pressures often leads to higher costs or inefficiencies. The recent experience of U.S. railroads in dramatically reducing railroad crew sizes and labor costs in the face of ever intense competitive pressures suggests the importance of competition in promoting efficiency. Many other industries have dramatically cut costs and improved efficiencies when no longer insulated from competitive pressures, such as following deregulation. Monopoly also results in higher prices and poorer service quality for customers; this can be seen as an unfair redistribution of income from customers purchasing the product at monopoly prices to producers. The impacts go beyond a matter of equity when customers of intermediate rail services lose international competitiveness as a result of higher prices and poor service. In sum, strong rail competition enhances efficiency and provides firms with the incentives to serve their customers well. Shippers benefit from lower rates and better service.

Preservation of rail competition is even more important as policy makers move towards a relaxation of rail regulation, as has been the case in recent years. Deregulation entails the substitution of market forces for government regulation in the determination of prices and service levels. However, to the extent there are significant barriers to entry, it becomes necessary to preserve competition in order to preserve the benefits of deregulation. The structure of the railroad industry is such that there are substantial barriers to entry, particularly because of the costs of constructing a new line. Keeler describes rail structure as follows:

[3] Scherer, R. M., Industrial Market Structure and Economic Performance, Chicago, Rand-McNally, 1980, pp. 3-4.

> In short, Baumol and the others have documented that, with very easy entry and exit, a natural monopoly has almost all the attractive characteristics of a competitive market, eliminating the need for regulation. They appropriately call such a natural monopoly a 'contestable' natural monopoly.
>
> If railroads constituted a contestable natural monopoly, it would greatly simplify the task of regulating them, because the marketplace could then be trusted to accomplish a large part, if not all, of the task of achieving efficient pricing and resource allocation in the industry. Common sense, however, indicates that the railroad industry is not contestable: entry entails a long and tedious process of buying up parcels of land, generally requiring power of eminent domain... Engineering and building a railroad line also require considerable time and expense. So entry into the industry is anything but easy.[4]

Thus, we must be particularly wary about reduction of competition in the railroad industry, in that there is little prospect of new rail lines being built to compensate for this diminution.

III. Importance Of Competition In Preserving And Extending The Benefits Of Staggers

The U.S. railroad industry has experienced a dramatic improvement in its financial condition since Staggers. By increasing operating freedoms and stimulating competition, deregulation spurred the railroad industry to cut costs. In particular, railroads post-Staggers have trimmed both labor and track to achieve a much better fit with available traffic. The industry has abandoned about one-third of its track, sharply reduced crew sizes, and used contracts to better align cars and equipment with shippers' demand. As of 1998, rail operating costs per ton-mile were 60 percent lower than when deregulation began.[5] Shippers have also generally benefited from Staggers in the form of lower rates.

The benefits to the industry and its customers, however, are highly dependent upon preserving and promoting intramodal competition in the railroad industry. This is particularly

[4] Keeler, Theodore, Railroads, Freight and Public Policy, Brookings, Washington, D.C., 1983, pp. 47-48.

[5] C. Grimm and C. Winston, "Competition in the Deregulated Railroad Industry: Sources, Effects and Policy Issues," forthcoming in S. Peltzman and C. Winston, Deregulation of Network Industries, Brookings, Washington, D.C.

true given the industry consolidation in the 1990s. The Burlington Northern-Atchison, Topeka and Santa Fe merger[6] and the *UP/SP Merger* left only two major railroads in the western United States, while Conrail's absorption by Norfolk Southern and CSX[7] left only two major railroads in the east. Given the current dominance by these four large railroads, it is particularly important to preserve competitive options provided by regional and short line railroads.

The consolidation of the largest Class I railroads has created a serious competitive imbalance between the "Big 4"[8] and the rest of the industry, creating a climate where the smaller railroads find it increasingly difficult to compete. Additional mergers would further accentuate this imbalance. For example, there are significant competitive benefits from having a strong North South rail competitive alternative—Canadian National Railway ("CN") and Illinois Central Railroad ("IC") in conjunction with alliance partner KCS. This independent alternative provides an essential competitive counterweight to the two dominant carriers in the East and West. If additional mergers eliminated this independent alternative, for example if the industry evolved to two North American systems, there would be a serious diminution of competition. For example, export grain shippers would lose an important rail service option under this scenario. It is a truism that preservation of competition is essential to preserve and extend the benefits of deregulation.

IV. The STB Should Give Greater Weight To Arguments Of Competitive Harm In Situations Where The Number Of Independent Rail Carrier Alternatives Within A

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[6] Burlington N. Inc. et al. – Control and Merger – Santa Fe Pac. Corp. et al., Finance Docket No. 32549 ("*BN/SF Merger*").

[7] CSX Corp. and CSX Transp., Inc., Norfolk S. Corp. and Norfolk S. Rwy. Co. – Control and Operating Leases/Agreements – Conrail Inc. and Consolidated Rail Corp., Finance Docket No. 33388 ("*Conrail Merger*").

[8] Union Pacific Railroad Company ("UP"), Burlington Northern and Santa Fe Railway Company ("BNSF"), CSX, and Norfolk Southern Railway Company ("NS")

Corridor Would Be Reduced By A Merger From Three To Two

The STB's Advance Notice of Proposed Rulemaking in this docket[9] characterizes its past approach as a "case-by-case examination based on the individual circumstances of each case." *ANPR* at 9. However, in recent merger cases there has in fact been a strong presumption and uniform conclusion that there will be no competitive harm from three to two situations. There was indeed an important shift in merger policy between the time of the first major post-Staggers parallel merger brought before the ICC in the mid-1980's – Santa Fe - Southern Pacific ("*SF/SP*") and the second brought before he Board in the mid-1990's – the *UP/SP Merger*. The *SF/SP* merger was denied by the ICC, with strong reference to three to two competitive effects as a basis in the decision. Yet, the UP/SP transaction had substantially stronger two to one and three to two competitive effects, but it was approved. Indeed, the Board acknowledged in the *UP/SP Merger* decision[10] that its policy had changed regarding three to two effects:

> When the ICC turned down an eleventh hour effort to formulate ameliorative conditions in the SF/SP merger it expressed similar concerns:
>
> > 'We are disinclined to risk the possibility of collusion and market splitting that might result from such an artificial, settlement induced rationalization of the western rail system...'
>
> Here, in contrast, applicants presented their plan for addressing competitive harms at the outset...The agency also has the benefit of nine years of additional experience with decreasing rates in two-carrier rail markets under Staggers Act deregulation. We now believe that rail carriers can and do compete effectively with each other in two-carrier markets.

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[9] Major Rail Consolidation Procedures, Ex Parte No. 582 (Sub-No. 1), Slip op. (STB served March 31, 2000) ("*ANPR*").

[10] *UP/SP Merger*, Decision No. 44, 1 S.T.B. 233 (1996), *petition for review denied sub nom. Western Coal Traffic League et al. v. STB et al.*, 169 F.3d 775 (D.C. Cir. 1999) ("*UP/SP Merger Decision*").

UP/SP Merger Decision at 385 (citation omitted).

Thus, contrary to the 1980's policy regarding three to two effects, the ICC and the Board changed its policy in the 90's and concluded that there would be no competitive harm in hundreds of markets where the UP-SP consolidation reduced the number of rail carriers from three to two, despite the fact that the merger involved $5.1 billion in rail freight revenues of three to two traffic. In many of these markets, UP and SP were the dominant two carriers before the merger. UP and SP had a combined market share of 70% or greater in around $2 billion of the three to two markets. As discussed in the Texas-Mexican Railway Company's Petition to Reopen Decision No. 44, the Board rested its conclusion that three to two effects would not be a problem heavily on two findings:

First, it stated:

> We have examined in detail the nature of the 3-to-2 traffic at issue, and have determined that it presents little potential for significant, merger-related competitive harm. Most of this traffic is either intermodal or automotive traffic that enjoys vigorous motor carrier competition.

Id. at 387. Second, it stated:

> Another key factor in our analysis is the limited role now played by SP as the third carrier in these markets. . . .As a result, SP's role, particularly with regard to the very service-sensitive automotive and intermodal traffic that makes up a large part of the 3-to-2 traffic, has diminished. (According to applicants, SP now handles only 20% of 3-to-2 traffic.) Two decades ago, for example, SP was the dominant automotive carrier in the West, with direct service to and from four automobile assembly plants in California. Since then, as a result of the closure of three of these four plants and SP's decline in service, SP has fallen to a very small share (less than 10% in 1994) of the automobile business handled by the western railroads. SP has been unable to make necessary investments in new automobile facilities and auto-handling freight cars.

Id. at 390.

However, neither of these findings applied to the Houston, Texas market. In terms of three to two effects, severe competitive harms resulted from the loss of a third major carrier.

First, unlike many other three to two markets discussed in the Board's decision, very little of the Houston three to two traffic was intermodal, automotive or otherwise subject to truck competition. Second, unlike many other three to two markets, SP had been a major competitor in Houston, far more significant than BNSF.

In terms of overall magnitude, the record from that case showed that more than $1.2 billion of three to two traffic either originated or terminated in the Houston Business Economic Area ("BEA") each year. Very little of that traffic was intermodal and less than 7% was automotive. Chemicals accounted for almost one-half of the traffic, fully $592 million. Of the Houston three to two traffic, three-fourths was transported greater than 600 miles and more than half was transported greater than 1200 miles making truck and other modal competition less likely.

Furthermore, unlike many other markets, SP had a major share of the Houston market, and its loss as a third competitor was arguably much more harmful to shippers in that market than elsewhere. Specifically, SP participated in 42% of Houston three to two traffic prior to the UP/SP merger. Furthermore, while SP was a very important competitor in Houston, in many Houston markets BNSF's presence was relatively small. UP and SP controlled 85-100% of the markets for $504 million of the Houston traffic. $307 million of this traffic was chemicals.

The post-merger dominance of the Houston market that was predicted in the original merger proceeding had clearly shown itself by the time of the UP/SP service crisis. Data presented in the Houston/Gulf Coast Oversight Proceeding[11] provided further evidence regarding the competitive effect of UP/SP in Houston. On a carload basis, the merged UP/SP had 80% of

[11] Union Pac. Corp. et al. – Control and Merger – Southern Pac. Rail Corp. et al., Finance Docket No. 32760 (Sub-No. 21).

Houston originating traffic and 89% of Houston terminating traffic to/from the Northeast in January—June, 1998. With regard to traffic to and from the South, UP/SP had 78% originating and 87% of terminating traffic in the first half of 1998.[12] These markets, although serviced by three carriers before the merger, were in fact closer in character to 2-to-1 markets, but the Board refused to grant competitive relief. UP and SP were the dominant carriers in Houston prior to the merger and a merged UP/SP remains the dominant player in a post-merger environment.[13]

That the reduction in competition from three to two in Houston was deemed not to be a significant competitive effect strongly suggests that the ICC and Board has moved away from a more balanced case-by-case approach to an evaluation of three to two's with a strong presumption that in general two railroads are enough. The change in policy was also suggested in the *BN/SF Merger* decision[14]:

> We would not necessarily be concerned if GNBC faced a reduction in competitive alternatives from three unrestricted alternatives (BN, Sante Fe, and UP) to two unrestricted alternatives (BN/Sante Fe and UP). Two independent railroads, we think, can provide strong, effective competition provided that, among other things, neither is subject to any artificial restrictions.

BN/SF Merger Decision at 776.

[12] Union Pac. Corp. et al. – Control and Merger – Southern Pac. Rail Corp. et al., Finance Docket No. 32760 (Sub-No. 26), Rebuttal Evidence and Argument in Support of the Consensus Plan (CMA-5/RCT-4/TM-21/SPI-5/TCC-5/KCS-12), Rebuttal Joint V.S. of C. Grimm and J. Plaistow, p. 3.

[13] In its November 27, 1996 decision denying the Tex Mex petition to reopen Decision No. 44, the Board argued that the 3-2 situation at Houston was "much the same as at other 3-2 points." Notwithstanding the relative market share of UP, SP and BN prior to the merger, the Board also stated that "the merger should actually strengthen competition in Houston by replacing SP with a stronger BNSF." *UP/SP Merger*, Decision No. 62, Slip op. at 6-7 (STB served Nov. 27, 1996). The dominant market share of the merged UP-SP, as clearly established in the UP/SP oversight case, undermines this prediction.

[14] *BN/SF Merger*, Decision No. 38, 10 I.C.C.2d 661 (1995) ("*BN/SF Merger Decision*"), *petition for review denied sub nom. Western Resources, Inc. v. STB et al.*, 109 F.3d 782 (D.C. Cir. 1997).

In the CSX and NS acquisition of Conrail, which presented three-two effects across a broad range of markets, the issue was no longer even considered by the Board. The policy has become established that merging carriers need only to provide a competitive fix for two to one shippers in order to solve competitive problems of their rail consolidations. The Board needs to return to a much closer scrutiny of three to two effects, as was the case in the 1980s.[15]

V. Economic Theory And Published Econometric Studies Evidence A Strong Consensus That Significant Competitive Harm Results In General When The Number Of Rail Carriers Are Reduced From Three To Two

Based on economic theory, there is no basis for a policy dismissing three to two competitive effects in rail mergers. As discussed by Kwoka and White, where a small number of firms compete in a market, most theories suggest that moving from three competitors to two in a market would lead to a diminution of competition and higher rates for shippers.[16]

In general, with additional firms, coordination or tacit collusion becomes more difficult, as a greater number of firms increase the probabilities that the firms will have different notions about what price levels will maximize profits. Therefore, as the number of competitors in an industry increases, the intensity of rivalry will also tend to increase. While two firms in any industry will in most instances compete to some degree with each other, rivalry will generally be more vigorous when a third firm is present, with customers receiving more options, better service and lower prices. With more firms, the chances are greater that any one firm will set off a fierce

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[15] In my opinion, if mergers continue without a change in policy, the ultimate result will be two major railroads in the entire United States. It is likely that this would be perceived as so destructive to competition and the needs of rail customers that the railroad industry would be re-regulated, which would not be in the public interest.

[16] For example, theories of "cooperative" behavior, the "Cournot" theory, and a "dominant firm" model would all suggest this outcome. Only a "Bertrand" theory would suggest otherwise. J. Kwoka and L. White, "Manifest Destiny? The Union Pacific-Southern Pacific Merger (1996)" in J. Kwoka and L. White, eds., The Antitrust Revolution, 3rd ed., 1998, Oxford University Press.

competitive skirmish or come up with a better way to serve customers. Accordingly, when a third rival is eliminated from a market, prices increase and service quality is diminished.

The existing academic research confirms that rail rates are significantly related to the degree of railroad competition – the number or concentration of railroad carriers that serve given shippers. Rail competition was shown to be important even while pre-Staggers regulation was still present. A study that I conducted (published in 1985) gathered 1977 data on rail rates and the degree of rail competition in 110 rail markets, as defined by specific origin-destination pairs. The study found a significant relationship between rates and rail competition at origin and destination, with added competition causing lower rates.[17]

Levin (1981) has provided insights through simulations on the social benefits of increasing competition in concentrated rail markets.[18] He has shown that, given various assumptions concerning demand elasticity and revenue/variable cost ratios, the social benefit of adding a second, equal-sized competitor to a monopoly market ranges from 6.8% to 18.9% of the revenues in that market. Adding a third railroad in a two-firm market yields social benefits of from 2.4% to 6.6% of revenues. This suggests that reduction of the number of competing railroads in a three to two market has a negative effect.

Two studies by MacDonald (1987, 1989) have used post-Staggers data to investigate the impact of rail competition on rates.[19] One study uses 1983 data regarding shipments of corn,

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[17] Grimm, C., "Horizontal Competitive Effects in Railroad Mergers," in T. Keeler, ed., Research in Transportation Economics, Vol. 2, 1985, pp. 27-53.

[18] Levin, Richard, "Railroad Rates, Profitability, and Welfare Under Deregulation," Bell Journal of Economics, Vol. 12, Spring 1981, pp. 1-26.

[19] McDonald, James M., "Competition and Rail Rates for the Shipment of Corn, Soybeans, and Wheat," Rand Journal of Economics, Vol. 18, 1987. McDonald, James M., "Railroad Deregulation, Innovation, and Competition: Effects of the Staggers Act on Grain Transportation," Journal of Law and Economics, Vol. 32, April 1989, pp. 63-95.

soybeans and wheat. Regressions are performed on the data to ascertain the relationship between rates and rail competition. McDonald concludes: "The analysis shows an important, statistically significant effect of concentration on prices in an industry with high barriers to entry and large capital commitments." A second study draws on data from 1981-1985 regarding grain shipments. It concludes:

> Competition among railroads has a statistically significant, fairly strong effect on rates. More competitors...are associated with lower rates. The addition or subtraction of a competitor has a larger effect on rates, the fewer the number of competitors in a market. For example, moving from a monopolist to a duopolist in a corn market seventy-five miles from water competition reduces rates by 17.4 percent, while moving further to triopoly reduces rates another 15.2 percent.

Additionally, a Brookings Institution study in which I participated (Winston, Corsi, Grimm, Evans, 1990) supported the importance of railroad competition in reducing rail rates.[20] Using 1985 data drawn over a large number of origin-destination pairs, we found that price-marginal cost margins[21] were significantly lower in markets with a greater degree of railroad competition. Clearly, rail competition (not just at the two to one level) is critical.[22]

In sum, there is no basis whatsoever for the change in STB policy that has occurred in the past decade regarding three to two effects. In the 1980s, three to two effects were considered so significant that they formed the basis for the denial of the *SF/SP* merger. In the 1990s, the Board

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[20] Winston, C., T. Corsi, C. Grimm and C. Evans, The Economic Effects of Surface Freight Deregulation, Brookings, Washington, D.C., 1990.

[21] More precisely, the price-marginal cost margins were weighted by the probability of a shipment moving by railroad. The reader is referred to Winston, Corsi, Grimm and Evans (1990), pp. 44-49 for further details.

[22] Many of these studies have been discussed in recent merger cases, particularly the *UP/SP Merger*. The Board has found them not to be relevant to competitive issues in that case, for reasons such as the data used in the study preceded the merger, or the commodities used in the study (e.g., MacDonald/grain) did not allow extension to a broader set of traffic. While these academic studies do not eliminate the need to focus on specific facts of a merger case, they strongly suggest that a presumption of no competitive harm from three to two's is not warranted.

has rarely, if ever, concluded that a three to two effect was harmful so as to warrant imposition of a condition. Clearly, as the industry becomes more concentrated, greater emphasis should be placed on preserving limited rail service options for shippers, especially in three to two markets.[23]

VI. The STB Should Adopt A "Structural Approach" To Analyzing Competitive Harms From Mergers

In moving towards a policy that preserves rail competitive options in mergers, the STB should consider adopting a broad-based structural approach. This kind of approach would provide a more refined assessment of the impact of a merger on market structure, as opposed to simply counting the number of railroads before and after a merger. Such an approach is commonplace for assessing mergers in other industries and in other countries.

The first step in such a structural approach would be to define relevant markets, for example rail traffic in origin-destination corridors. The second step is to analyze market structure prior to the merger as indicated by the market shares of participants. Commonly, a measure of market concentration, such as the share held by the leading firm or firms, is used.[24] The third step is to analyze the change in market structure in a given market from the merger. If the structure is substantially more concentrated following the merger, there is a strong presumption of competitive harm.

Importantly, such an approach is sensitive to differing impacts of three to two mergers.

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[23] Without a change in policy, it is likely that the industry would eventually merge itself down to two railroads. The creation of two transcontinental rail carriers would raise a host of concerns. These two major rail systems would dominate short line and regional railroads and thwart the influence those smaller carriers currently have on rail prices and services. Large mega-systems may also suffer diseconomies of scale and would definitely reduce shipper's bargaining leverage.

[24] Another common measure of market structure is the Herfindahl index, which is calculated by summing the square of each firm's market share.

Such an approach is also consistent with my foregoing comments that three to two effects in markets such as Houston are significant. Under this approach, when the two dominant firms in a market merge, the structural approach would indicate a significant impact, whereas the impact would be much smaller if the dominant firm in a three to two market were not involved in the merger.

For example, the Houston—St. Louis market shares for chemical traffic prior to UP/SP were: SP-47%, UP-38% and BNSF-12%. A structural approach using the market share of the leading firm as a measure of concentration would show an increase from 47% to 85% after a UP/SP merger. Indeed, post-merger analyses of the combined UP/SP market share for such traffic, described above, serves to validate a structural approach. On the other hand, a hypothetical merger of UP and BNSF would generate an increase of leading firm market share of only three points, from 47% to 50%. Thus, this approach can aid in selective identification of significant competitive effects in three to two markets. While the KCS proposal would create a presumption disfavoring three to two effects, it is consistent with a structural analysis as it provides an opportunity, if substantial public interest justifications warrant, to not impose a condition in some three to two situations.

VII. Conclusion

The STB is appropriately re-considering its merger rules at this point. The rail merger wave of the 90's has produced a highly concentrated railroad industry. It is time for the STB to elevate the importance of competition in public interest evaluation of rail mergers. The Board should establish a policy whereby shippers experience no reduction in competitive options. The strong presumption that reducing competitive options from three to two is insignificant should be eliminated.

STB Ex Parte No. 582 (Sub-No. 1)

I, Curtis M. Grimm, verify under penalty of perjury that the foregoing is true and correct based on my knowledge, information and belief. Further, I certify that I am qualified and authorized to file this verified statement.

Curtis M. Grimm

Curtis M. Grimm

Dated: May 10, 2000

SUBSCRIBED AND SWORN TO before me this 10th day of May, 2000.

My Commission expires: September 13, 2003

Notary Public

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PRESENT POSITION

Professor and Chair; Logistics, Business and Public Policy; College of Business and Management; University of Maryland; College Park, MD 20742.

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EDUCATION:

Institution	Degree	Date	Field
University of California, Berkeley	Ph.D.	6/83	Economics

Major Areas: Industrial Organization, Transportation and Econometrics/Statistics

Ph.D. Dissertation: Strategic Motives and Competitive Effects in Railroad Mergers (Ted Keeler, Advisor)

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University of Wisconsin, Madison	B.A.	5/75	Economics (with honors)

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PREVIOUS EMPLOYMENT:

Visiting Research Fellow, Bureau of Transport and Communication Economics, Canberra, Australia, July 1991 - January 1992.

Economist, Office of Policy and Analysis, Interstate Commerce Commission, Washington, D.C., January 1981 - December 1981.

Assistant to the Chief of Intercity Transport Development, Planning Division, Wisconsin Department of Transportation, Madison, October 1977 - August 1978 and November 1975 - July 1976.

AIESEC (International Association of Students in Economics and Commerce) Trainee, Swedish State Power Board, June 1975 - September 1975.

PUBLICATIONS

Books and Monographs

1) C. Winston, T. Corsi, C. Grimm and C. Evans, The Economic Effects of Surface Freight Deregulation, Brookings Institution, Washington, D.C., 1990.

2) Deregulation of Domestic Aviation: The First Year, Bureau of Transport and Communication Economics, Australian Government Publishing Service, Canberra, Australia, 1991 (lead author).

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75) Grimm, C., "Public Interest Evaluation of Recent Rail Mergers," 1981 Eastern Transportation Law Seminar Papers and Proceedings, Association of ICC Practitioners, Washington, D.C., pp. 171-176.

76) Grimm, C., "Promoting Competition in the Railroad Industry: A Public Policy Analysis," Transportation Research Forum Proceedings, 1984, pp. 222-227.

77) Grimm, C. and K. Smith, "Impact of Deregulation on Railroad Strategies and Performance," Transportation Research Forum Proceedings, 1985, pp. 540-544.

78) Corsi, T., C. Grimm and R. Lundy, "ICC Exemptions of Rail Services: Summary and Evaluation," Transportation Research Forum Proceedings, 1985, pp. 86-92.

79) Corsi, T., C. Grimm and R. Smith, "Motor Carrier Strategies in a Changing Environment: An Empirical Analysis," Transportation Research Forum Proceedings, 1986, pp. 177-180.

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81) Smith, E., M. Gannon, C. Grimm and G. Young, "Competitive Advantage in Diverse Industries," Proceedings of the Second Biennial High Technology Conference, University of Colorado, Boulder, Colorado, January 1990.

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Grimm, C., "Combining Scholarly Research with Public Policy Evaluation," ITS Review, Vol. 5, No. 2, Institute of Transportation Studies, University of California, February 1982.

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Grimm, C., "Preserving and Promoting Rail Competition," Report to the National Industrial Transportation League, 1984.

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Roberts, M., T. Corsi and C. Grimm, "Benefit-Cost Analysis of Weight Limit Exemption for Vehicles Carrying International Freight in the Route 50 Corridor," Study Prepared for the State Highway Administration, State of Maryland, February 1988.

Cambridge Systematics; Leeper, Cambridge and Campbell; T. Corsi, and C. Grimm, "A Guidebook for Forecasting Freight Transportation Demand," NCHRP Report 388, National Academy Press, Washington, D.C. 1997.

CONTRACTS AND GRANTS:

Course Development Grant, Joint MS Program in Telecommunications.

University of Maryland Center for International Education and Research (CIBER)

Research Award, 1991.

University of Maryland Dingman Center for Entrepreneurship Research Award, 1990.

Small Business Administration, Small Business Development Center, University of Maryland. From 1985 - 1989, Ken Smith, Martin Gannon and I received funding to establish Center for the counseling and training of small business managers. We also conducted research on strategic management of small businesses, including travel agencies and electronic firms. (Amount: $200,000)

Department of Education Business and International Education Program. During 1988 and 1989, I was part of a team which received a two-year grant for curriculum development, research and professional outreach. The program involves collaboration with the Maryland Port Authority on research, outreach and internships. (Amount: $110,000).

Maryland Department of Transportation. During 1987/88 I worked with Tom Corsi and Merrill Roberts on a contract to study the impact of exempting Eastern Shore export container traffic from the 80,000 pound highway weight limitation. (Amount: 35,000).

University of Maryland Grant to Integrate Computer Use into the Classroom, 1985.

University of Maryland General Research Board Summer Research Award, 1984.

CONFERENCE PAPER PRESENTATIONS:

"Public Interest Evaluation of Recent Rail Mergers," presented at the 11th Association of ICC Practitioners' Eastern Transportation Law Seminar, October 1981.

"Stand-Alone Costs: Use and Abuse in Railroad Maximum Rate Determination," presented at the Eastern Economics Association Annual Meeting, March 1984 (with Philip Fanara).

"Promoting Competition in the Railroad Industry," presented at the Transportation Research Forum Annual Meeting, October 1984.

"The Politics of the Budget Deficit and the Role of Political Interest Groups," presented at the Annual Meeting of the Association for Public Policy Analysis and Management, October 1984 (with John Holcomb).

"Impact of the Staggers Act on Rates and Shipper Quality: Role of Shipper Size and Competition," presented at the American Economics Association/Transportation and Public Utilities Group Annual Meeting, December 1984 (with Ken G. Smith).

"The Effects of Railroad Mergers on Industry Performance and Productivity," Transportation Research Board Conference on Rail Productivity, University of Illinois, June 1985, (with Robert G. Harris).

"Environmental Variation, Strategic Change and Firm Performance: A Study of Railroad Deregulation," presented at the Annual Meeting of the Academy of Management, August 1985 (with Ken G. Smith).

"Management Characteristics, Strategy, and Strategic Change," presented at the Strategic Management Society Annual Meeting, Barcelona, Spain, October 1985 (with Ken G. Smith).

"Impact of Deregulation on Railroad Strategies and Performance," presented at the Transportation Research Forum Annual Meeting, November 1985 (with Ken G. Smith).

"ICC Exemptions of Rail Services: Summary and Evaluation," presented at the Transportation Research Forum Annual Meeting, November 1985 (with Thomas M. Corsi and Robert Lundy).

"Excess Branchline Capacity in the Railroad Industry," presented at the Transportation Research Board Annual Meeting, January 1986.

"The Economics of Coal Transportation: Implications for Railroad Shipper Strategies," presented at the Transportation Research Board Annual Meeting, January 1986 (with Les Selzer and Kent Phillips).

"The Organization as a Reflection of its Top Managers: An Empirical Test," presented at the Annual Meeting of the Academy of Management, August 1986 (with Ken G. Smith).

"Motor Carrier Strategies in a Changing Environment: An Empirical Analysis," presented at the Transportation Research Forum Annual Meeting, September, 1986 (with Thomas M. Corsi and Raymond Smith).

"Shifts in Use of Owner-Operators Among LTL General Freight Carriers Since the

Motor Carrier Act of 1980," presented at the Transportation Research Forum Annual Meeting, September, 1986 (with Thomas M. Corsi).

"Environmental Variation, Decision Comprehensiveness and Performance," presented at the Strategic Management Society Annual Meeting, Singapore, October, 1986 (with Ken G. Smith, Martin Gannon, and Terence Mitchell).

"Gambit and Repartee: A Theory of Competitive Action and Responses," presented at the Annual Meeting of the Academy of Management, August 1986 (with Ken G. Smith).

"The Impact of the Environment on Personnel Policies: Management Characteristics in the U.S. Railroad Industry," presented at the Annual Meeting of the Academy of Management, August 1987 (with James Guthrie and Ken G. Smith).

"Mobility Barriers in the Motor Carrier Industry," presented at the Transportation Research Forum Annual Meeting, November 1987 (with Thomas M. Corsi).

"Railroad Cost Structure - Revisited" presented at the Transportation Research Forum Annual Meeting, November 1987 (with Tony Barbera, Kent Phillips and Les Selzer).

"The Impact of Rail Rationalization on Traffic Densities: A Test of the Feeder Line Theory." presented at the Transportation Research Board Annual Meeting, January 1988 (with Les Selzer and Kent Phillips)..

"Porter's Generic Strategies and Organizational Size," presented at the Strategic Management Society Annual Meeting, October 1988 (with Ken Smith).

"Predictors of Competitive Responses in the Domestic Airline Industry," presented at the Strategic Management Society Annual Meeting, October 1988 (with Ken Smith and Martin Gannon).

"ATLFs: Driving Owner-Operators into the Sunset," presented at the Transportation Research Forum Annual Meeting, November 1988 (with Thomas M. Corsi).

"Competitive Strategic Interaction: Action Characteristics as Predictors of Response," presented at the Annual Meeting of the Academy of Management, August 1989 (with Ming-Jer Chen and Ken G. Smith).

"Strategies and Performance in the Truckload General Freight Segment Before and After Deregulation," presented at the Transportation Research Forum Annual Meeting, October 1989 (with Thomas M. Corsi).

"Rivalry in the U.S. Domestic Airline Industry," presented at the Strategic Management Society Annual Meetings, October 1989 (with Ken Smith and Martin Gannon).

"Building Competitive Advantage in Diverse Industries," presented at the Boulder, Colorado Conference on the Management of the High Technology Firm, January 1990 (with Greg Young, Ken Smith, and Martin Gannon).

"Economic Effects of Surface Frei t Deregulation," presented at the Transportation Research Board Annual Meeting, January 1990 (with Cliff Winston and Thomas Corsi).

"Strategies of Challenging Airlines at Hub-Dominated Airports," presented at the Transportation Research Forum Annual Meeting, October 1990 (with James Kling and Thomas M. Corsi).

"Size, Strategy, and Performance: LTL Motor Carriers," presented at the Transportation Research Board Annual Meeting, January 1991 (with Raymond Smith and Thomas Corsi).

"The Role of Firm Reputation in Competitive Interaction," presented at the Annual Meeting of the Academy of Management, August 1991 (with Leith Wain, Martin Gannon and Ken G. Smith).

"The Advantage of Size in the U.S. Trucking Industry," presented at the Transportation Research Forum Annual Meeting, November 1991 (with Carol Emerson and Thomas M. Corsi).

"The Impact of Entry and Concentration in Australian Aviation: A Test of Contestability Theory," presented at the Transportation Research Forum Annual Meeting, October 1992.

"Reevaluating Returns to Scale in Transportation," presented at the Transportation Research Forum Annual Meeting, October 1993 (with K. Xu, R. Windle and T. Corsi).

"Access and Competition Policy in the US Rail Freight Industry: Potential Applications to Telecommunications," presented at a conference on Sustaining

Competition in Network Industries through Regulating and Pricing Access, CITI, Columbia University, November 1993 (with R. Harris).

"Engaging Competitors," presented to the Whitmore Conference, Dartmouth College, New Hampshire, September 1994, (with G. Young and K. Smith).

"Engaging a Rival for Competitive Advantage: Firm Resources and the Competitive Environment as Predictors of Competitive Firm Activity," presented at the Annual Meeting of the Academy of Management, August 1994 (with G. Young, A. Schomburg and K. Smith).

"David and Goliath: Strategies for Challenging the Dominant Rival," presented at the Annual Meeting of the Academy of Management, August 1994 (with K. Smith, T. Corsi and J. Kling).

"Wealth Effects of New Product Rivalry," presented at the 14th annual international conference of the Strategic Mangement Society, Paris, September 1994 (with H. Lee, K. Smith, and A. Schomburg).

"Business Distress and a Firm's Propensity to be Rivalrous," presented at the 14th annual international conference of the Strategic Mangement Society, Paris, September 1994 (with C. MacFhionnlaoich and K. Smith).

"Industrial Organization Economics, Resource-Based Theory, and Schumpeterian Perspectives on Competitive Advantage: Toward an Action-Based Model of Advantage," presented at the Annual Meeting of the Academy of Management, August 1995 (with K. Smith).

"Strategic Groups and Rivalrous Firm Behavior: Towards a Reconciliation," presented at the Annual Meeting of the Academy of Management, August 1995 (with K. Smith and G. Young).

"Shareholder Wealth Effects of New Product Rivalry," presented at the Annual Meeting of the Academy of Management, August 1995 (with H. Lee and K. Smith).

"Creative Destruction and Competitive Dynamics: An Action-Based Study of Industry Dethronement and Market Share Erosion," presented at the Annual Meeting of the Academy of Management, August 1996 (with W. Ferrier and K. Smith).

"The Rate of International Alliance Formation: The Role of Firm Resources, Strategy, and Industry Structure," presented at the Annual Meeting of the Academy of Management, August 1996 (with G. Young and K. Smith).

"An Assessment of the Validity of Competitive Dynamics Research," presented at the Annual Meeting of the Academy of Management, August 1996 (with G. Young, M. Becerra and K. Smith).

"The Rate of International Alliance Formation: The Role of Firm Resources, Strategy, and Industry Structure," presented at the 16th annual international conference of the Strategic Management Society, Tempe, Arizona, October 1996 (with G. Young and K. Smith).

"Performance Implications of Market and Non-Market Actions," presented at the Annual Meeting of the Academy of Management, August 1997 (with T. Quasney and B. Shaffer).

"Multimarket Contact, Resource Heterogeneity, and Rivalrous Firm Behavior," presented at the Annual Meeting of the Academy of Management, August 1997 (with G. Young and K. Smith).

"Performance Implications of Market and Non-Market Actions," presented at the Annual Meeting of the Academy of Management, August 1997 (with T. Quasney and B. Shaffer).

"Techniques of Transportation Analysis: Costs," discussant at Transport Policy and Economics Conference in Honor of John R. Meyer, Kennedy School of Government, Harvard University, September 1997.

"A Conceptual Model of Supplier-Reseller Satisfaction Perceptions in Distribution Channels," Academy of Marketing Science, Coral Gables, Florida, 1997 (with C. Emerson and R. Krapfel).

"The Impact of Financial Condition on Competitive Behavior: Towards a Reconciliation of Competing Views," presented at the Annual Meeting of the Academy of Management, August 1998 (with C. MacFhionnlaoich, W. Ferrier and K. Smith).

"Competitive Effects of Railroad Mergers," Transportation Research Forum Annual Meetings, Philadelphia, October 1998 (with J. Plaistow).

"The Canadian Experience with Competitive Access, " Transportation Research Board Annual Meeting, January 1999.

"Predicting Order and Timing of New Product Moves: The Role of Top Management," presented at the Annual Meeting of the Academy of Management, August 1999 (with A. Srivasta, H. Lee and K. Smith).

"Competition in the Deregulated Railroad Industry: Source, Effect and Policy Issues," presented at the AEI-Brookings conference on Deregulation of Network Industries, December, 1999.

RESEARCH AWARDS:

Award for best paper, marketing channels track, Academy of Marketing Science conference, Coral Gables, Florida, 1997.

Award for the best airline paper and best paper overall, 1990 Transportation Research Forum Conference.

Plowman Award for the best paper, 1987 Transportation and Logistics Educators Conference.

Regular Common Carrier Conference Award for the best motor carrier paper, Transportation Research Forum Annual Meeting, September, 1986.

EDITORIAL AND REVIEWING ACTIVITIES:

Consulting Editor (1991-1993) Journal of the Transportation Research Forum.

Editorial Review Board, Journal of Transportation Management (1993-present).

Editorial Review Board, Journal of the Transportation Research Forum (1993-present).

Book Review Editor for the Journal of the Transportation Research Forum (1988-1991).

National Review Board Member, Academy of Management Annual Meetings, Business Policy and Planning Division.

PROFESSIONAL AFFILIATIONS:

American Society of Transportation and Logistics; Transportation Research Forum; American Economics Association & Transportation and Public Utilities Group; Transportation Research Board/Member, Committee on Freight Transport

Regulation; Academy of Management; Strategic Planning Society.

TEACHING AND ADVISING:

Courses Taught

BMGT 370 (Introduction to Transportation: also served as course coordinator)
BMGT 372 (Introduction to Logistics Management)
BMGT 476 (Computer Models in Transportation and Logistics)
BMGT 495 (Business Policy)
BMGT 670 (Economic Environment of Business)
BMGT 671 (Managerial Economics)
BMGT 770 (Transportation Theory and Analysis)
BMGT 798 (Field Studies in Industry and Competitor Analysis)
BMGT 808 (Seminar in Industrial Organization and its Application to Strategic Management)
ENTS 631 (Telecommunications Policy)

Teaching Awards

Allen J. Krowe Award for Teaching Excellence, College of Business and Management, 1988.

Selected as one of the top 15% teachers in the College of Business and Management (12 times)

Member of the Following Ph.D. Dissertation Committees:

Tom Quasney (chair)
Wally Ferrier (co-chair)
August Schomburg (co-chair)
Greg Young (co-chair)
Hun Lee (co-chair)
Carol Emerson (chair)
Cormac Mac Fhionnlaoich (co-chair)
Pam Derfus (co-chair)
Ayesha Malhotra
Stephanie Head
Chris Lin
Constantinos Christou
Chul Moon
Deborah Lyons

Jane Feitler
Laura Power
Ming-Jer Chen
Harry Sapienza
Jack Scarborough
James Kling
Robert Trempe
George Rubenson
Ven Sriram
Raymond Smith
Ritu Lohtia
Jason Chang
Douglas Meade
Barbara Houchen
Leith Wain
John Burgess
Douglas LaBahn
Ker-Tsung Lee
Yeon Myung Kim
Steven Chien

SERVICE:

Department Chair, Transportation, Business and Public Policy Group (December 1994-present).

Chair of Search Committee, Executive Director of the Center for Knowledge and Information Management, 1999.

Member, CRC T&P Committee, Don Riley (1998).

Chair, Extra Merit Step for Non-Exempt Employees Committee, 1999.

Member, MBA 4th Track Committee (subcommittee of executive committee) (1996-1998).

Member, Strategic Planning Committee (subcommittee of executive committee). (1996-present).

College Workload coordinator (responsible for attending meetings with Provost and reps re: workload requirements and taking lead on filling out compliance forms).

Member, Executive Committee, Middlestates Accreditation Committee, University (Dan Fallon/Nelson Markley, Chair), Dec. 1995-1997.

Member, Faculty Composition and Development Section, AACSB Accreditation committee (1995).

Lead College Member on Campus Committee to form and fund a Global China Institute (1995).

Chair of Search Committee, Transportation, Business and Public Policy Faculty Positions (1994-5, 1995-6, 1996-7, 1997-8, 1998-9, 1999-2000).

Member, College Strategic Planning Committee (drafted section on MBA program), 1994-5.

Chair, MBA Oversight Committee, College of Business and Management (May 1994-Jan. 1995).

Member, MBA Oversight Committee, College of Business and Management (1992-1994).

Chair, ELM Coordinator's Committee, College of Business and Management, (1993-1994).

Member, External Communications Committee, College of Business and Management, 1994.

Chair, PR on Academic Quality Committee, 1993.

Member Technology Advancement Program Business Screening Panels (1986-1990).

Member, Faculty Grievance Hearing Board, College Park Campus (1991).

Member, College Budget Committee (1990-1991).

Member, Strategic Planning Steering Committee, and Chair, MBA Subcommittee, College of Business and Management (1989-1990).

Member, General Committee on Faculty Affairs, College Park Campus Senate (1984-1986, 1987-1988).

Elected Representative to the College Park Campus Senate (1988-1991).

Member, Graduate Committee, College of Business and Management (1987-1988).

Chairman, MBA Case Competition Subcommittee of the Graduate Committee (1987).

Faculty Assistant Coordinator, MBA/Rutgers Invitational Case Tournament (1986-1987).

Faculty Judge, MBA Case Competition, College of Business and Management (1989).

Member, Undergraduate Committee, College of Business and Management (1987-1988).

Faculty Co-Advisor, University of Maryland Transportation and Logistics Club (1985-1990).

Member, International Task Force, College of Business and Management (1986-1987).

Member, Dean's Computer Integration Task Force, College of Business and Management (1986-1988).

Participant in Planning Session for External Activities, College of Business and Management, Wye Woods (Sept. 1987).

Member of Search Committee, Transportation, Business and Public Policy Faculty Positions (1985-1988, 1992).

In November, 1995, I presented testimony before the United States Senate and House Committees on Small Business at a joint hearing on "Railroad Consolidation: Small Business Concerns."